RBC Wealth Management

The business owner's guide to wealth management

Ten key decisions for business owners

Wealth Management

RBC Wealth Management

RBC Wealth Management® provides comprehensive services designed to address your multi-faceted financial concerns, simplify your life, give you the freedom to pursue your other priorities and provide you with the confidence that your goals will be achieved.

Whether you need assistance managing your family's wealth, maximizing your business investments or providing stewardship for non-profit assets, RBC Wealth Management brings together the solutions you need in key areas such as financial planning, private banking, investment management and estate and trust services.

Tailored to your individual needs by your RBC® advisor, RBC Wealth Management provides the specific services you need, today and in the future. Your RBC advisor, supported by a team of specialists drawn from RBC Wealth Management member companies, helps you address your various wealth management needs through each stage of your life:

- Accumulating wealth and growing your assets
- Protecting your wealth by managing risk
- Managing the affairs of a loved one
- Converting your wealth to an income stream
- Transferring wealth to your heirs
- Creating an enduring legacy

RBC Wealth Management Publications

To help you understand your choices and make informed decisions, RBC publishes a wide variety of financial, tax and estate publications, written by leading authorities on wealth management for high-net-worth Canadians. Please ask your RBC advisor for information about other RBC Wealth Management publications.

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Whether you're already a business owner or thinking about becoming one, the decisions you make will have far-reaching implications – not only for your business, but also for you and your family.

A business consumes a large portion of your resources, time and attention throughout its lifetime, and your family's financial security may depend on its success.

This guidebook follows the life cycle of a business and its owner. It explores a range of subjects unique to business owners, from consideration of the best structure for your business, to development of a succession plan and your transition from the business into a well-planned and well-funded retirement.

Planning ahead can protect the business you've worked so hard to build, help you achieve your business goals and ensure your future prosperity. Your professional legal, tax and investment advisors are there to help you make the critical decisions, wherever you happen to be, on the challenging and rewarding journey through the life cycle of your business.

This guidebook is for information only and is not intended to be or to replace legal or tax advice. Please be sure to consult a qualified legal and tax advisor before implementing any strategies.

Key decision 1: What is the best structure for your business?

Make the right choice for yourself

A sole proprietorship is the simplest form of business organization and is often the most inexpensive to set up.

Whether you already own your business, are thinking of starting a business from scratch or are buying an existing business, choosing the right business structure can have a major impact on the future success of your enterprise as well as your personal tax and estate planning.

Your decision should take into account a range of factors including the nature of your business and where it's located, the number of people involved, taxation considerations, your potential exposure to liability and the company's financial requirements.

Consult an experienced legal professional and tax accountant. Your professional advisors can help ensure that you are well informed on the legal and taxation issues you may encounter and that you understand the personal and business implications of your decisions.

Sole proprietorships

A sole proprietorship is the simplest form of business organization and is often the most inexpensive to set up. This can be a good option for small enterprises or when you are just starting your business because you, as the business owner, have direct control over business decisions and receive all the profits. However, with this kind of structure, you are legally responsible for the debts and obligations of the business. This means that both your business and personal assets may be subject to the claims of creditors. This is called "unlimited liability".

How is a sole proprietor taxed?

You must file a personal tax return to report your business income. You should include the income, or losses, from your business on your personal tax return as part of your overall income for the year. Your net business income is taxed as personal income, so there are limited tax planning opportunities; however, you may be able to deduct your business losses from your other income sources.

Partnerships

Partnerships can be relatively easy to set up and often have low start-up costs. A key advantage of having partners is that they generally bring additional sources of investment capital and provide a broader management base. However, finding suitable partners can be a challenge. In addition, this kind of business structure can mean a division of authority, so there is potential for conflict between the partners.

A written partnership agreement, though not required, can help minimize potential conflict. In many cases it sets out the terms of business, protects the interests of individual partners in the event of disagreement or dissolution of the business and generally defines how the partners will share the business profits.

Your personal liability for the business and the actions of your partners can differ depending on the type of partnership. Be prepared for the possibility that your partners' decisions will be legally binding on you, and ensure you discuss all aspects of this decision with your legal advisor.

If you are considering investing in a partnership, you should review the tax and legal implications carefully with your professional advisor.

How is a partnership taxed?

A partnership is not a taxable entity. This means that instead of the partnership paying tax, the partnership's income or loss flows to the individual partners, who report their proportionate share of income or loss on their personal tax returns.

Corporations

Corporations are a very popular business structure. A corporation is a separate legal entity from its shareholders and has the legal characteristics of an individual. It can own property, incur legal liability, lend, borrow and carry on a business.

If you're thinking of starting or investing in a corporation, there can be a number of advantages. It can provide greater business continuity as shares can be bought and sold without affecting the company's continued operation. It is also easier to raise investment capital for a corporation, and you may find that the size and resources of an incorporated business make it easier to attract specialized management expertise. In addition, as an owner-manager and a shareholder, your liability is generally limited to your shareholding, so your personal assets are protected from the company's creditors unless you have provided personal guarantees for loans to the corporation.

It's important to obtain legal advice when setting up or acquiring an incorporated business. Corporations are more closely regulated than sole proprietorships or partnerships and may be more costly to set up. You will be required to hold annual shareholder meetings, meet certain record-keeping obligations and comply with requirements under the legislation governing their corporation. This can mean more administrative, legal and accounting expenditures.

If you are a professional and are thinking of incorporating your practice, please review Appendix 2 for information specific to professional corporations.

How is a corporation taxed?

Since a corporation is a separate legal entity, a corporation files its own corporate tax return and pays taxes on the income it earns. A corporation's income is calculated separately from the business owner's or shareholder's personal income.

Business planning quick tip

Inexpensive and simple to set up, sole proprietorships are generally more suitable for smaller enterprises with a single owner/manager who wants direct personal control. Costs are usually higher with partnerships and corporations, but it's easier to raise investment capital, making them a better choice for larger enterprises. They also offer tax and legal advantages that may appeal to certain enterprises regardless of size. The good thing is that you can change your business structure as your business develops and circumstances change.

Which business structure is right for you?

	Sole proprietorship	Partnership	Corporation
Cost	Lowest cost option	Relatively low start-up costs	Higher set-up and ongoing costs
Level of control	Direct personal control	Shared with partner(s)	Potentially shared with a number of other stakeholders, including shareholders and directors
Legal liability	Unlimited personal liability	• General partners: full liability jointly shared between partners • Limited partners: liability limited to amount invested	Liability transferred to corporation, which possesses same legal rights, obligations and liabilities as a person
Convenience	Easiest to set up and manage	Generally easy to set up and manage	Typically more complex administrative requirements, including tax, legal and regulatory filings
Business continuity	Difficult due to its reliance on a single individual	Other partners can help ensure continuity	As a separate legal entity, a corporation can continue even when its original shareholders move on
Investment capital	Raising new capital can be difficult	Partners can bring investment capital	Shareholders can invest substantial new capital
Tax considerations	Taxed personally	Partner's share of profit/loss is taxed personally	• Corporation files the tax return • Tax advantages can include small business deduction, capital gains exemption and income splitting

Tax planning for corporations

As an owner-manager, you may be able to benefit from some of the tax planning opportunities available to incorporated businesses:

- The small business deduction provides potential tax-deferral opportunities and a reduced corporate tax on active business income up to the small business limit that is retained in the corporation.
- If your business qualifies as a qualified small business corporation (QSBC), all or a portion of any gain realized on the sale of the shares can potentially be sheltered from personal taxation using the capital gains exemption.
- By incorporating, you may have the opportunity to split income and reduce taxes by paying dividends to adult family shareholders.
- Adding other family members as common shareholders directly or through a family trust (referred to as an "estate freeze") can allow you to transfer future tax liability on the growth of the company to lower-income family members and multiply the use of the capital gains exemption on the sale of QSBC shares.

Talk to your professional advisors about the structure that's right for your business or whether your current structure is providing what you need to achieve your goals.

Key decision 2: How can you reduce taxes?

Organize your business assets in the most tax-efficient manner

There are several income-splitting strategies available to owners of private corporations in Canada that may benefit you and your family.

As a business owner, you may have substantial personal assets invested in your business in addition to the long-term commitment you have made to your business and its employees. This can have significant implications, not only for you and your business but also for your family's financial security.

To protect your investments, both business and personal, your business strategy should include carefully structured tax and estate planning components to ensure you have organized your assets in the most tax-effective manner and utilized the tax planning strategies that are available for the benefit of your business and your family.

Personal tax planning[1]

There are several income-splitting strategies available to owners of private corporations in Canada that may benefit you and your family. They include:

Income splitting by paying a salary to family members

Consider income splitting with lower-income family members by employing them in the corporation and paying them a reasonable salary based on the services they perform. The salary they receive will also create Registered Retirement Savings Plan (RRSP) contribution room for them and generate Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) pensionable earnings. Note that the tax rules provide a disincentive to paying a salary or bonus that exceeds the value of the services rendered.

Income splitting by paying dividends to adult family members

If you have an active corporation, you may be able to transfer some or all of the future growth of the business to the next generation of your family using an estate freeze with a family trust. This common business succession strategy allows you to income split by paying dividends from the corporation to your spouse and adult children. If they have no other income, they may be able to receive substantial tax-free dividends from the corporation (the amount varies depending on the type of dividends and the family member's province/territory of residence). While this strategy may help you minimize and defer tax, there may be situations in the future where you may wish to unwind or dissolve the structure. Ensure that this flexibility is available in the design of your estate freeze before it is initially put into place.

Multiplying the capital gains exemption

It is possible to "multiply" the capital gains exemption available to you and your family on the sale of the qualifying shares of your business. This could significantly increase the family's after-tax assets following the sale. One way to do this is by having your operating company owned by

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[1] On July 18, 2017 the federal government released a consultation paper proposing a number of strategies which target private corporations with regards to income splitting, multiplication of the lifetime capital gains exemption, holding a passive investment portfolio inside a private corporation, and converting a private corporation's regular income to capital gains.

Generally, effective for 2018 and later taxation years, the government has proposed to limit income sprinkling to family members receiving "reasonable" compensation from a private corporation. The proposed measures extend the tax on split income rules (often known as "kiddie tax") to adults and limit the multiplication of claims to the lifetime capital gains exemption.

The government is also seeking input on possible measures to eliminate the tax advantage of investing undistributed earnings from an active business in a private corporation. If enacted, these measures may result in a disincentive for investing passively within a corporation.

The strategies discussed in this publication may be affected by the proposed measures in the consultation paper and the accompanying proposed legislation. If you are an owner of a private corporation you should consider the potential impact of the proposed measures and discuss the implications with your qualified tax advisor.

a family trust where your family members are the beneficiaries of the trust. When you sell the qualifying shares owned by the trust, the resulting capital gains can be allocated to each beneficiary and they can each claim their capital gains exemption. For example, a family of four can claim four times the capital gains exemption versus the business owner, who can claim the capital gains exemption only once. This results in additional tax savings for the family.

You may also wish to consider some potential estate planning opportunities. Freezing the value of your estate can help you limit your tax liability on death. You can also defer capital gains on the future growth of the business and attribute them to the next generation while retaining control of the business. This may also allow other family members to use their capital gains exemptions.

Remember that for these strategies to be effective, the interest, dividends and capital gains must be paid or payable by the family trust to the beneficiaries. The funds will no longer belong to you as the parent or business owner, so ensure this is a practical strategy for your circumstances.

Tax planning for your business

If you're the owner of a private Canadian corporation earning active business income, consider whether the following strategies would work for your business:

By maintaining your operating company's status as a QSBC, when you eventually sell its shares, you may be able to take advantage of the capital gains exemption. This exemption is available to individual shareholders of active Canadian private corporations and can represent a sizable tax saving.

Setting up a retirement plan

Consider setting up an Individual Pension Plan (IPP) as part of your retirement plan. An IPP is a defined benefit pension plan that, in certain situations, provides greater annual contribution limits than an RRSP. IPP contributions increase with the age of the plan holder.

Contributions to the IPP are tax-deductible for your corporation. The investments in the IPP grow on a tax-deferred basis and are only taxable when you start withdrawing from the IPP.

If investment earnings in the plan are lower than expected, you may be able to make additional contributions.

IPP assets may offer creditor protection and typically suit business owners who are age 40 or older and earn significant employment income. This means that you will need to draw a salary from your business.

Maintain the status of your corporation as a qualified small business corporation

By maintaining your operating company's status as a QSBC, when you eventually sell its shares, you may be able to take advantage of the capital gains exemption. This exemption is available to individual shareholders of active Canadian private corporations and can represent sizable tax savings.

To qualify for the exemption, ensure your corporation meets the QSBC status. Certain corporate structures may make this easier. Since surplus assets may limit your ability to claim the exemption, you may want to transfer non-business investments to a holding company. This can "purify" the operating company and reduce the accumulation of non-qualifying assets.

Business planning quick tip

If you own a private Canadian corporation, you can take advantage of several strategies to reduce taxes. These tax strategies include income splitting with lower-income family members, maintaining your small business tax status if you are planning to sell the shares of your corporation and investing surplus assets in a tax-exempt insurance policy and other tax-efficient investments.

Earning Canadian dividend income in a corporation

Canadian source dividends from corporations that are not controlled by the shareholder corporation are subject to a flat refundable corporate tax. If you are earning Canadian public company dividends in a corporation, consider paying out a dividend in the same year if you will be paying taxes at a lower tax rate personally.

Life insurance as a tax-exempt investment in the corporation

If you have surplus funds accumulating in your corporation, you may be taxed at a higher rate on the investment income earned in the corporation than if you earned this income personally (depending on the province/territory). You may also face double taxation on the assets within the corporation on death. Tax planning solutions are available that may help you address this problem.

A corporate-owned tax-exempt life insurance policy can provide income protection for survivors, fund buy-sell agreements or pay capital gains tax on death. Life insurance premiums are generally not tax-deductible, but it can be advantageous to purchase life insurance through a corporation rather than personally. The corporation's surplus assets can be invested in the insurance policy, grow on a tax-sheltered basis during your lifetime, provide a supplementary source of retirement income and be paid to your beneficiaries as a tax-free death benefit.

Please contact us for more information about strategies that may reduce your personal and corporate taxes.

Key decision 3: What should you do with surplus cash?

Preserve and maximize your surplus assets

If you have surplus cash in your corporation, ask yourself if you will need it for business purposes in the short term.

If you are the owner-manager of a private Canadian corporation and have surplus cash accumulating in your company, you may be wondering whether to retain the funds in the company or withdraw them while paying as little tax as possible. If so, there are a number of questions you should consider before you take action.

Is there a business need for the cash?

If you have surplus cash in your corporation, ask yourself if you will need it for business purposes in the short term. Will you need to use the cash to pay instalments of income tax or GST/HST? Does your business experience seasonal slow periods when cash flow will need to be supplemented? Consider whether you will have to pay down debts or make any major purchases in the near future.

If you have excess cash that won't be used for business purposes, the investment income earned on this surplus cash will be taxed at the corporate investment tax rates, which may be slightly higher than top personal tax rates, which vary by province/territory.

Do you need the surplus cash for personal purposes?

Do you have personal expenses that are coming due, such as income tax instalments that must be paid on time? You may also be considering a major purchase like a vacation property or planning to help out with a family member's education costs, wedding expenses or house down payment. If you know you will need to withdraw surplus funds from the corporation to meet these personal expenses, consider when you will need the funds. It's important to understand the tax consequences of making the withdrawal and whether it will be possible to make several withdrawals over a period of time to minimize tax costs.

What are the funds going to be used for?

If you don't need the surplus funds immediately for business or personal purposes, what are your reasons for moving funds out of the corporation? Sometimes, it may be beneficial to withdraw the funds from the corporation, as investment income earned on the excess funds remaining in the corporation may be taxed at a slightly higher rate than the highest personal tax rate. A good starting point is to analyze your long-term goals, which could include:

- **Planning for retirement** – Are you going to use the funds for your retirement by contributing to an RRSP, IPP or RCA?
- **Estate planning** – Do you want to enhance the value of the estate you will pass on to your family? Many potentially effective estate planning strategies involve insurance-based

solutions. The funds may grow on a tax-sheltered basis and may be accessed at retirement to supplement retirement income, or they may be paid out tax-free on death.

- **Asset preservation** – If you want to mitigate the risk of funds being subject to claims from corporate creditors, consider transferring excess cash to a holding company. There are various ways to accomplish this.

- **Tax planning** – Keeping excess investments or an insurance policy in a corporation may disqualify your shares from being QSBC shares so that you are not entitled to the capital gains exemption on the sale of your business. Therefore, you may want to withdraw excess funds from the corporation. A properly structured corporation may allow you to extract cash from the operating corporation on a tax-deferred basis.

Withdrawing funds from the corporation

If you've decided to take funds out of your corporation, consider potential strategies that could help you make the withdrawal and minimize the tax consequences.

Tax-free strategies

- **Expense reimbursement** – Keep records of business expenses you paid personally. If your corporation reimburses you, you won't pay tax on the funds you receive and the corporation may get a tax deduction for the business expense.

- **Repayments of shareholder loans to the company** – Shareholder loans, such as personal assets you transferred to the company without payment or dividends declared but never paid to you, can be repaid without tax consequences.

You could also consider other non-taxable methods such as paying a capital dividend if your corporation has a positive capital dividend account balance.

Taxable strategies

Taxable methods of withdrawing funds from the corporation include paying yourself a higher salary or dividend. Although paying a taxable dividend results in personal tax, it may at the same time create a tax refund to the corporation if the corporation has a "refundable dividend tax on hand" (RDTOH) balance. In some circumstances, the refund to the corporation may be greater than the personal tax paid on the dividend. Income-splitting opportunities may also be available, for example, by paying a reasonable salary to a lower-income family member for services rendered or paying dividends to adult family member shareholders.

We can provide a range of services to help you preserve and maximize your surplus assets. Please ask us for more information.

Business planning quick tip

You can use a simple "decision tree" to analyse the issues related to surplus cash in your business and how it may be used:

1. Consider whether there is a business need for the surplus cash any time in the foreseeable future.
2. If there's no business need, consider whether you have an impending personal need.
3. If not, consider longer-term goals, such as retirement or asset protection.
4. Should you decide to withdraw surplus funds, consider the most tax-effective ways to do so.

Key decision 4: How can you build employee loyalty?

Provide enhanced benefits to attract and retain top talent

Employer-sponsored savings plans are one of the most important aspects of retirement planning and can help you ensure that your employees enjoy a financially secure retirement.

As a business owner you know how important it is to recruit, reward and retain your top talent.

It can help ensure business continuity and protect the knowledge you have accumulated within your organization, and it may help you make effective succession planning decisions when the time comes. The loss of a key employee can be very expensive to an organization, so give some thought to how you can motivate key employees and keep them focused on the company's priorities.

Employer-sponsored savings plans

Employees are increasingly conscious of the necessity to provide for their retirement. Employer-sponsored savings plans are one of the most important aspects of retirement planning and can help you ensure that your employees enjoy a financially secure retirement. Before setting up a retirement plan, discuss the options with your professional legal, tax and/or financial advisors. Here are some of the more common types of retirement plans offered by employers.

Group Registered Retirement Savings Plans (Group RRSPs)

Group RRSPs are one way you can encourage your employees to save for retirement throughout their careers. They could be an option even for a small business owner. These plans operate like regular RRSPs, possibly with additional restrictions, and can be more cost-effective and easier to administer than pension plans.

Registered Pension Plans (RPPs)

RPPs are employer-sponsored pension plans. In general, employer and employee contributions are tax-deductible and the income earned within the plan grows tax-deferred. Funds accumulating within the plan for individual members are generally locked in by provincial/territorial or federal legislation. There are two kinds of RPPs:

Defined contribution (DC) and Defined benefit (DB) pension plans

Employees with DC pension plans choose the investments within their individual plans, and the retirement benefit is based on the value of the investments in the plan when the employee retires. This can be a less costly option than a DB plan for you as an employer and is easier to administer.

In contrast, DB plans guarantee a specific benefit to the employee at retirement, calculated using a formula based on earnings and years of service. DB plans generally specify an age, usually 65, at which employees are expected to start receiving retirement income. As an employer, you face a potentially greater obligation with a DB plan than a DC plan because you are making the investment decisions and guaranteeing a fixed benefit to the employee at retirement. If there are insufficient funds in the plan, you may also be required to top up the plan by making a greater current cash flow commitment to the DB plan than expected. If there is a surplus in the plan, you may have reduced payments.

Business planning quick tip

Financial incentives like enhanced retirement benefits can help you retain your key employees, but don't forget about non-financial aspects such as career development and work/life balance.

Enhanced retirement benefits

The following options may help you enhance the retirement savings plans of your key employees:

Supplemental Executive Retirement Plans (SERPs)

Limits on registered plan contributions and benefits can leave your higher-income employees with retirement benefits that are inadequate to maintain their standard of living. A SERP may help bridge the gap between the maximum pension available under the company's RPP and what a higher-income employee would otherwise have received. It can also be a way to help you retain your valuable employees and encourage their long-term loyalty.

One of the most common forms of SERPs is an RCA. An RCA is a non-registered pension arrangement that can help you provide supplemental pension benefits for key employees. RCAs have no contribution limits (provided contributions are "reasonable") and no investment restrictions. Employees may also be able to benefit from certain investment strategies involving life insurance. This can provide supplemental tax-exempt investment income and may yield better results than alternative investments.

Individual Pension Plans (IPPs)

As previously mentioned, an IPP is a DB pension plan.

It can be set up for a business owner but also for key employees to provide for their retirement.

IPPs are typically suited for those who are age 40 or older and earn significant employment income.

Learn from experience

While financial compensation often attracts your key employees, non-financial benefits often help you retain them. Sufficient tools and time to do the job are essential to employee satisfaction, while training and career development help to keep them motivated. Aim to foster a social environment and a sense of team, and demonstrate your commitment by ensuring that work/life balance can be achieved.

If you lose a key employee, hold an exit interview so you understand the reasons for their departure. Their dissatisfaction may indicate problems among other key employees and may save you from another costly loss.

We can help you assess the advantages of enhanced employee benefits, including RCAs, IPPs, Group RRSPs, and assist you in setting up these plans. Please contact us for more information.

Key decision 5: How will you reduce your risk?

Safeguard your personal and business assets from creditors

Depending on the province/territory you live in, placing funds in an insurance policy (life or segregated funds) may safeguard them from potential future claims.

As a business owner, you've worked hard to accumulate your assets, so it's important to take precautions to protect them from risk. Review your situation and consider if you need to "creditor protect" your business. If you operate as a sole proprietor or a partnership, your personal as well as business assets may be at risk from creditors with a claim against your business.

There are a number of potential solutions. One is to keep your personal and business assets separate wherever possible and carefully structure your holdings to minimize your potential liability before any insolvency issues arise. This can be an effective way to protect yourself, particularly if you undertake such planning in the ordinary course of your business. The following are some other strategies that may help:

Protect personal assets

- **Gifting assets** – If you gift assets to family members, you may reduce the number of assets that may be available to your creditors, but bear in mind that those assets may now be at risk from creditors of the family members who receive them. Unless the gift is to a spouse, it's considered a sale at fair market value for Canadian tax purposes and could potentially trigger a capital gain.
- **Using insurance** – Depending on the province/territory you live in, placing funds in an insurance policy (life or segregated funds) may safeguard them from potential future claims. In many cases the investment component of an insurance policy and the interests of the beneficiaries under the insurance policy may offer protection from the claims of creditors.
- **Sheltering assets within registered plans** – Funds in an RRSP are potentially protected from creditors in certain provinces/territories. In very specific circumstances, some RRSPs have received a favourable judicial ruling following the death of the plan holder, particularly where there was a named beneficiary. Remember that registered pension plans governed by pension legislation may also offer protection from the claims of creditors, subject to specific exceptions.
- **Transferring assets to a formal trust** – The legal ownership of the assets passes to the trustee, so, if properly structured, these assets could be protected from future creditors. However, you may lose control of the funds transferred, depending on the nature of the trust. Determine whether you can afford to transfer control of those assets. If you can, choose a trustee who you know will manage them appropriately. Remember there could be significant tax implications in placing assets in a trust, so obtain professional advice to ensure you understand the consequences before you make a decision.

It is possible to appoint RBC Estate & Trust Services* as your corporate trustee. One of the key benefits of using RBC Estate & Trust Services as a corporate trustee is the security of knowing you are engaging experienced professionals to protect the interests and requirements of your trust. RBC Estate & Trust Services can administer the trust and invest the assets according to the directions set out in the trust agreement. Speak to your RBC advisor for more information on how RBC Estate & Trust Services can help.

* Naming or appointing RBC Estate & Trust Services refers to appointing either Royal Trust Corporation of Canada or, in Quebec, The Royal Trust Company.

Safeguard your business

When you're working on a strategy to protect your business assets from risk, certain actions can create the impression that you intend to put assets beyond the reach of creditors. This can work against you in the event of a lawsuit and can be particularly important if your company is experiencing financial difficulties. Try to avoid the following:

- Transferring property for less than fair market value
- Paying for property by cash instead of cheque
- Transferring property without proper documentation
- Transferring property where the transferring person retains an ongoing interest or continues to behave like the property owner
- Transferring property without a change in possession

Protecting your corporate assets may involve transferring them between a number of separately incorporated businesses. The idea is that if one business fails, it won't leave another in a vulnerable position. It is important to demonstrate that each corporation is a legitimate legal entity, carrying on business independently. Ensure that transfers between companies occur at fair market value and are documented as though they occurred at arm's length. To reinforce this, if you have a number of corporations with a common trade name, ensure that all documentation is prepared in the correct corporate name and signed by the authorized signing officer. Each corporation should have separate management, so try to avoid shared processes like accounting, banking and inventory management.

To protect your valuable business assets, an operating company should aim to own only the minimum number of assets necessary to carry on its business. If possible, these assets should be owned by another company and leased back to the operating company so they are not available to creditors in the event of a claim.

Benefits of incorporation

Incorporating your business may be one way to protect personal assets. As an owner-manager, you are only liable to the extent of your shareholding, so you are not personally liable for the debts of the company. Compare this with sole proprietors, who are personally liable for all the debts and obligations of their businesses, and partnerships, where

you can be personally liable for the actions of other partners. If you do incorporate, be careful about giving personal guarantees for loans to your business. The protection provided by incorporation can be lost in such a case and you could be personally liable for the repayment of the loan.

Surplus assets in your business

Consider keeping cash reserves low. If you have accumulated surplus assets in your business that you don't need for operating expenses, consider transferring them to a holding company. This can help protect them from creditors of the operating company. You should also consider the pros and cons of having your company contribute to an IPP. This can help boost your retirement funds and assets in an IPP are creditor protected.

Please contact us to review the opportunities you have to safeguard your personal and business assets from creditors.

Business planning quick tip

Many small business owners dedicate most of their financial resources to their business. As a result, it is often difficult to distinguish between "personal" and "business" assets. But by separating personal and business assets and implementing legitimate strategies for both, you can protect yourself against potential creditor claims.

Key decision 6: What can you do to deal with the unexpected?

Prepare a plan to protect your business before adverse events occur

Key person protection can be a cost-effective way to help protect your business against the consequences of losing a critical individual, whether they leave by choice or due to death, a critical illness or a disability.

Would your business be prepared if a catastrophic event occurred? Do you have a plan to cover the potential loss of a key person who leaves by choice or due to a serious illness, a disability or death, or to mitigate the consequences of a divorce, which can have a substantial impact on a family business?

Planning ahead can help you limit the damage to the business you have worked so hard to build and to which you have committed so many resources. You protect yourself by insuring against risks like fire, damage to your premises and theft of equipment, but an unforeseen event for which you haven't planned can seriously affect your ability to deliver services to your customers. Lack of planning can be detrimental to the value of your business, company morale and business performance.

Insurance solutions

Insurance can provide some financial security if you are unable to work or earn an income due to an accident or illness. As a business owner, your continued presence may be critical to the company's ongoing success. Several insurance strategies may be particularly significant in ensuring business continuity and security:

- Purchase insurance to help you pay overheads and specific expenses you will continue to be responsible for, even if you are temporarily incapacitated.
- Fund a buy/sell agreement through an insurance policy. It can be a cost-effective way to enable business owners to purchase the shares of a partner or shareholder in the event of their death, a disability or a serious illness. This may allow you to take immediate steps to minimize the potential damage by reassuring employees, creditors, suppliers and investors; and ensure that the family of the partner or shareholder receives financial support.
- Insure against the loss of a key person. Key person protection can be a cost-effective way to help protect your business against the consequences of losing a critical individual, whether they leave by choice or due to death, a critical illness or a disability. You estimate the financial impact of this loss on your company and insure against the occurrence of specific events. Your business may receive compensation to the extent of the coverage you have purchased, and this can help you manage unexpected expenses resulting from the loss.
- Consider the potential benefits of providing group insurance for your employees. This can be a valuable addition to your compensation structure, can help ensure long-term employee loyalty and may make your company attractive to talented prospective employees.

Retaining top talent

Many organizations misunderstand what employees and prospective employees are looking for from an employer. This may be one reason why organizations have difficulty attracting employees with the skills they need.

For a large percentage of organizations, mental health is a major cause of short-term disability claims. The trend appears to be increasing. Employees claim that the main reasons for leaving their employer were stress, lack of confidence in management, dissatisfaction with opportunities for promotion, base pay and lack of work/life balance.

Analyse the potential business consequences of losing your most talented employees. To retain these valuable people, get to know them, reward them, keep them challenged and engaged, foster a team environment, offer them growth opportunities and provide a comprehensive and competitive remuneration package. These factors may help you maximize productivity and ensure business continuity.

Consider a family business divorce strategy

Divorce can have a major financial and emotional impact on a family business. It can also have an adverse effect on non-family members who work in the business. Consider the impact a divorce could have on the company morale, relationships and business performance. You may be able to minimize some of the negative effects through careful legal, succession and tax planning, but don't overlook the benefits of a comprehensive family business divorce strategy. It can be an invaluable piece of forward planning.

Consider a pre-nuptial agreement as a way to avoid some of the conflict associated with divorce. While it may be difficult to discuss the subject, such an agreement can be a great tool.

If the family business is the family's largest asset, a divorce can result in the sale of the business and division of the proceeds between the former spouses. In such a case the valuation of the business is often the central issue. It can be highly contentious and should be an essential element of a family business divorce strategy.

A business valuation expert used in a family business divorce strategy can help:

- Resolve divorce issues and buy-out situations, as business partners will have a shared understanding of what the business is worth.
- Achieve agreement on the fair market value of the business by obtaining input from everyone involved.
- Obtain an objective valuation based on the research done.
- Educate everyone so they understand the valuation and how it was determined.

If you plan for the unexpected, you can help your business weather developments that may otherwise have a potentially negative impact. In addition to insurance and strategies to retain your key employees and mitigate the effects of divorce on the family business, don't forget basic precautions. Ensure that computer systems are backed up and that important business and operational information is effectively communicated throughout the company to reduce risk in the event of the loss of key individuals.

At RBC, we can help evaluate and manage the various risks you and your business face. Please contact us for more information.

Key decision 7: Do you intend to retire from your business?

Create an exit strategy for a smooth transition into a well-funded retirement

If members of your management team are interested in purchasing the company, consider a management buyout or setting up a share ownership plan to transition your business.

If you should ever decide to retire, consider that some business owners develop a strategy for exiting their business, but many who are approaching retirement age haven't yet discussed their plans with family or business partners.

Whether you intend to sell the business to a third party, transfer it to family members, structure a management buyout or wind it up, advance planning can help you make better long-term decisions and increase the chances of a successful transition. It can increase the funds you will be able to withdraw to help fund your retirement, make management transitions easier and give you a wider range of options. In the next few decades, many small businesses will be changing hands. If you haven't yet discussed a business succession plan, or even considered your intentions for the business when you retire, now is the time to think about it.

Will your business provide enough to fund your retirement?

A family-owned business often represents more than half the value of the owner's estate. Consequently, if much of your net worth is tied up in the business, you may be less well diversified than those who have a more traditional retirement portfolio. Remember that unlike a salaried employee, it's up to you to fund your own retirement. Do you have a strategy? Are you relying on being able to sell your business for a sum that will enable you to enjoy a financially secure retirement? If you haven't given further thought to that far-off day, consider that many business owners are unable to sell their businesses for a variety of reasons. These include difficulties finding a suitable buyer and obtaining financing for the successor once they have been identified.

To avoid the situation where you're ready to retire but can't find a purchaser of the business, consider grooming your own replacement so that they're ready to step in and buy the company when you're ready to retire. Your options could include a current co-owner, key employees or a younger family member who is already active in the business.

If members of your management team are interested in purchasing the company, consider a management buyout or setting up a share ownership plan to transition your business. This may help you ensure business continuity, harness the business experience of your management team, and by reducing disruption during the transition period, you may increase the likelihood that the company will retain its existing customers and suppliers. For these and other reasons, management buyouts are often more successful than passing the business to family members or third parties.

Don’t leave the planning to the last minute

Don’t expect to put together an effective succession plan in a short period of time. Many business owners underestimate how long it takes to create a plan. Now is the best time to start thinking about succession planning for your business. This may seem a low priority when you’re consumed with the pressures of day-to-day operations, but it’s the best time to do it. Begin by writing down your goals and get professional legal, tax and accounting advice on setting up a succession plan.

Be conservative when you’re planning for retirement. It’s often natural to be optimistic, particularly if your business has always provided well for you and your family and you’ve assumed that it will be your main source of retirement savings. Maximize other sources of retirement income, like RRSPs or IPPs for example, and however much you love what you do, don’t leave your retirement planning too late. Allow time to find potential buyers to ensure you get the best possible offer for your business. Here are some tips to consider:

- Start working on your succession plan as early as possible
- Set realistic goals
- Review your plan regularly
- Identify the qualities you’re looking for in a successor (e.g. skills, resources)
- Assemble a team of professional advisors (e.g. business broker, experienced legal advisor, tax specialist, financial advisor) to help you put your plan together

Where is your business in its life cycle?

Where your business is in its life cycle can influence your retirement planning. Your focus will change as the business moves through different stages, so be flexible in your approach. Early on you may have few resources or little time to give to retirement planning. Later on when you’re established, you may have more time and resources – however, it’s never too early to start planning for retirement.

During the early years and periods of growth, build retirement planning into your decisions by diversifying and directing surplus assets to RRSPs, IPPs, tax-exempt life insurance and/or non-registered investments. Obtain professional tax advice to help maximize cash flow to build these assets. You may also be able to split income with family members and that can be beneficial when you eventually sell the business. Build a comprehensive estate plan, including putting Wills and Powers of Attorney/Mandates in place, and keep them up to date as circumstances change.

If your established business is generating surplus cash flow, you could be paying taxes in the highest tax bracket. While you’re focused on further expansion, remember to continue to diversify and direct surplus assets to retirement planning. You may now have funds for more sophisticated strategies that may help you save tax and further your retirement and estate planning objectives.

By the time your business is mature, you should have an exit strategy. Consider the following:

- Can the business generate enough income to fund your retirement?
- If you intend to sell the business, will you sell shares or assets? On the sale of QSBC shares, you may be able to utilize the capital gains exemption.
- Can you utilize opportunities like a payment of a retiring allowance and repayment of shareholder loans to help fund your retirement?
- Will you transfer the business to a family member? Have you identified a potential successor?

- Is an estate freeze a possibility? See "Key decision 2 – How can you reduce taxes?" to learn more about estate freezes.

Long-term planning may not be uppermost in your mind when faced with your current day-to-day business challenges, but a business succession plan can improve the overall value of your business and help maintain its strategic direction. Setting goals and timelines helps keep you on track and forces you to think long-term. During the planning process you may also identify talented future leaders and others who could take on pivotal roles. You can then ensure they get the training and experience they'll need when the time comes.

We can help you plan a successful retirement from your business and work with you to build a financial plan to help you reach your goals. Please contact us for more information.

Business planning quick tip

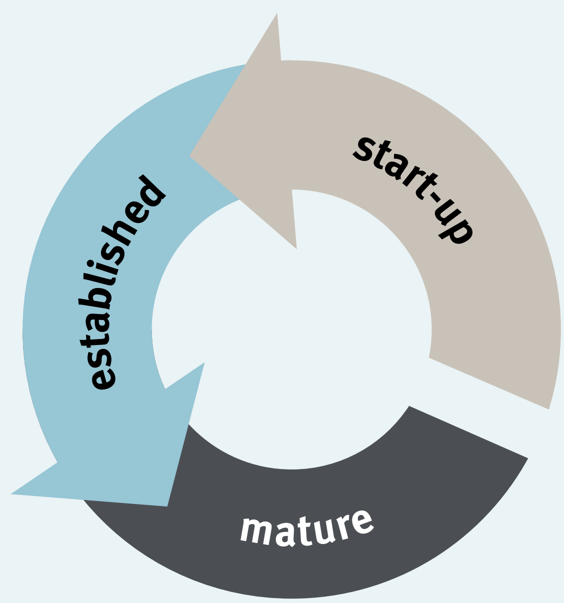
Holding some of your retirement savings outside the business can reduce your risk. If you withdraw profits, they may be protected from future business losses. By paying yourself a salary, instead of taking dividends, you can benefit from a personal income tax deferral by contributing to an RRSP or an IPP. Your business is entitled to pay you a retiring allowance when you retire, whether you sell the business or pass it on to a family member. The allowance may qualify for a rollover to an RRSP on a tax-deferred basis, subject to certain limits. It's also possible to incorporate insurance into your retirement strategy, for example, to help fund buy-sell agreements and maintain operations in case the business loses a key person, or cash values may be accessed to provide income.

The business owner life cycle

Start-up
Begin retirement planning now

Established
Develop your exit strategy

Mature
Consider tax-efficient strategies for surplus assets



Key decision 8: Will you sell your business?

Get top dollar by making your business more attractive to potential buyers and minimize taxes on the sale

A broker can act as your agent while you're looking for a purchaser and during the negotiations.

If you are planning to sell your business to a non-family member, you are not alone. Many business owners in Canada will exit their business by selling to a non-family member, but only a small percentage of owners planning to transfer their business in the near future have a succession plan. This apparent lack of succession planning is often due to the difficulty in finding a suitable buyer with financing to close the purchase.

If you're selling your business outside the family, consider the factors that can make your business more attractive to a prospective purchaser. It will be easier to find a buyer for a business that has potential for future growth. Other corporations in your business sector may also be interested in acquiring your business with a view to improving its profitability.

Valuation is of central importance. You can get an indication of this by researching the selling price of similar businesses in your area. Remember that small businesses can sell for significantly less than the asking price. Buyers may evaluate your business on its projected cash flow for the next few years and assess the value of that cash flow against the business risks.

To help you find a purchaser and obtain a better offer:

- **Have a valid reason to sell** – But try not to disclose personal information that could weaken your negotiating power.
- **Don't wait until you're under pressure to sell for economic or emotional reasons** – This can force you to accept a poor offer.
- **Gather essential information** – This may include:
  - Three years' financial statements and tax returns
  - Lists of fixtures and equipment
  - Lists of employees and customers
  - Copies of leases for premises and equipment
  - Franchise agreement
  - Lists of loans and payment schedule
  - Names of professional advisors, for example, business broker, qualified legal advisor and tax specialist
- **Have financial statements audited or reviewed by a professional for the sale** – This will increase the confidence potential buyers will have in the accuracy of the documents you provide.
- **Consider hiring a business broker to help you identify a purchaser** – A broker can act as your agent while you're looking for a purchaser and during the negotiations.
- **Maintain confidentiality** – Don't divulge information about your day-

to-day business activities that can be used by competitors. Ask a potential buyer to sign a non-disclosure agreement and provide financial information only to potential buyers who have paid a deposit.

- **Don't let the business decline while you're preoccupied with the sale** – Maintain your premises, inventory and normal business hours.
- **Learn to judge whether a potential buyer is serious** – Don't waste time on tire kickers.

Assemble a team of experts to help you

Your team of experts should include an experienced tax advisor to ensure you have planned your sale in the most tax-efficient manner, a qualified legal professional to prepare legal documentation and a business valuator. By working with your RBC advisor, you can create a financial plan that can give you an idea of what level of after-tax sale proceeds will be adequate to meet your retirement goals. They can also help you manage the investment of the sale proceeds.

Business planning quick tip

Keep your business going strong right up until the time you sell it. The tendency among many business owners is to start winding things down as they approach their retirement date. However, an actively managed business that's still growing will be much more attractive to potential buyers and will likely fetch a higher selling price.

Hiring a business broker

Give your broker information about your business and then follow their advice. Here are some factors to consider:

- You can maintain confidentiality during the early stages of the sale process and let the broker deal with potential purchasers on your behalf until they identify an acceptable prospect.
- Potential buyers may be more comfortable talking to an intermediary.
- Some brokers specialize in a particular industry and may have contacts at corporations that may be interested in buying your company.
- Brokers' fees are usually a percentage of the final sale price. Weigh this expense against the benefit they provide before you hire them.

We strongly advise you to consult an experienced legal professional when you're selling your business. A professionally prepared document summarizing your business for potential purchasers can be invaluable and may help you avoid potential litigation and suggestions of misrepresentation if the purchaser finds the business less successful than expected. Your legal advisor should also prepare the sale and purchase agreement so that all contingencies are covered and you minimize the risk of future litigation.

Tax minimization strategies

The following strategies may help you minimize the tax consequences when you're selling your active business to an outside buyer. Some strategies must be undertaken well before the closing date, so remember to plan ahead.

- If the purchaser is buying the shares of your business, you may be able to claim the capital gains exemption if your shares qualify as QSBC shares.

- Consider the pros and cons of setting up an IPP or an RCA, which may help you defer some of the tax upon a future sale.
- If you have a prospective purchaser of your unincorporated business, consider incorporating and selling the shares to utilize the capital gains exemption.
- If the shares of your business are sold, consider reinvesting some of the proceeds in the shares of another active Canadian private company in the year of sale or within 120 days after the year of sale in order to defer some of the capital gains tax on the sale.
- If the sale isn't imminent and the value of your business is increasing, an estate freeze and reorganization of your corporation may allow future capital gains to accrue to other family members and possibly multiply the use of the capital gains exemption.
- If you pay yourself a retiring allowance before the sale, you may be able to transfer a portion to your RRSP, tax-deferred, if you had years of service before 1996, irrespective of your available contribution room.
- Use some of the sale proceeds to make a charitable donation in the year of sale. The donation tax credit may help you minimize the tax on any capital gains realized on the sale. If your donation is expected to be at least $25,000, then consider the benefits of setting up your own charitable foundation in the year of sale through the RBC Charitable Gift Program.
- Consider receiving the sale proceeds over several years using a capital gain reserve to spread the gain and the resulting taxes payable over a longer period of time.
- If you are selling to management or employees, consider setting up a share purchase plan to facilitate the transition. This type of plan can help you ease into the transition and allow them to fund the purchase over time.

Please ask us for more information on making the most of your business sale proceeds for your retirement. We can help you develop a comprehensive financial plan and provide a wide range of retirement planning and investment services.

The RBC Charitable Gift Program is specifically designed for individuals and families wishing to support charitable causes in a meaningful way, without the time and cost associated with establishing a private foundation. It is an easy and convenient way to support charitable causes you care about, today and in the future, while receiving important tax benefits. Through this program, you can make initial and ongoing contributions to a charitable gift fund administered by the Charitable Gift Funds Canada Foundation (CGFCF), one of the leading charitable foundations in the country. Ask your RBC advisor for our brochure on the RBC Charitable Gift Program and how this form of charitable giving may be right for you.

Key decision 9: How can you keep your business in the family?

Plan ahead to maintain stability in the business – and the family

When you have identified a successor, involve them in your succession plan and share your long-term goals with them, your family and key employees.

While management buyouts are often more successful than passing the business to family members or third parties, this may not be the case for all industries and businesses. Owners of businesses employing family members often place significant importance on keeping the business in the family compared to owners of businesses not employing family members. This is particularly so for agriculturally based businesses. Many small and medium-sized enterprise owners employ at least one family member, and statistically, family businesses often play a bigger role in local communities, place greater emphasis on customer loyalty and foster a culture of shared values. This may allow for a successful and smoother transition.

What are the challenges to keeping a business in the family?

There are a number of challenges unique to running a family business and planning its future. Consider the interaction of family, business and ownership values and interests. There are long-standing relationships between family members that will still be there long after the transition, so don't overlook family dynamics. Is there a suitable successor within the family, and if so, can they work with others in the family who may also be involved in the business?

The high failure rate of inter-generational business transfers can be attributed to a combination of factors. These include the lack of a formal succession plan, a tendency to leave succession planning too late and the absence of clear communication. When you involve family members and discuss their concerns, such open communication helps clarify expectations of everyone's roles and commitment to make the transition a success. Don't assume that you understand the needs and perspectives of your relatives and employees. Address potential issues, perhaps by means of a family council, rather than avoiding them.

Involve your heirs and key employees in your succession planning

Owners of family businesses often assume they are "on the same page" as their chosen successors. This may be one reason why they are less likely to have a formal succession plan than those selling the business outside the family. It's a risk to assume that one of your children or another family member wants to take over the business. They may have other plans. When you have identified a successor, involve them in your succession plan and share your long-term goals with them, your family and key employees. Their input can minimize potential conflict and help maintain stability in the business and the family.

It's never too early to start building your succession plan

Don't underestimate the value of starting the process early. If you start to design your succession plan many years ahead of your expected exit date, you can build the interest of potential successors within the family by involving them in meetings and asking for their input. This can help them make an informed decision about whether they want to participate and to what extent.

If you don't have one family successor in mind yet, consider splitting the business and its responsibilities between family members. Who has been actively involved in the business and shown an aptitude and desire for leadership? Given the differing levels of commitment that your children may have shown, should you divide the business equity equally between them? The business may be your largest asset. Can you recognize their contributions in other ways and is it appropriate for children who are not actively involved in the business to be shareholders?

Obtain professional advice from your legal advisor, tax specialist and possibly a family business facilitator. A facilitator can help you discuss issues with family members, provide objectivity, find constructive ways to resolve conflicts, review plans, establish priorities and involve stakeholders in the succession process.

Create and implement a business succession plan

- **Develop a leadership profile –** What do you want to see in a future leader?
- **Identify suitable candidates –** Who demonstrates the commitment and leadership qualities you're looking for? Assess their experience and the gaps in their education. How can these be remedied?
- **Prepare management and personal development plans –** Project the company's future management needs and guide the career paths of individuals to meet them.
- **Mentor and evaluate candidates –** Develop their skills and leadership qualities. It can be difficult for a parent to do this objectively due to conflicting roles of parent/business owner. Choose someone else as mentor.
- **Select a succession –** Your choice could be clear due to years of preparation, or if not, use set criteria to make your selection. Your business facilitator can help.
- **Communicate your plan –** Ensure everyone understands the plan and their proposed roles. A business facilitator can help with communication and coaching.
- **Manage the transition –** Withdrawing from daily business activities can be difficult. A gradual transition may work best.

Continuing involvement after succession

Will you have an ongoing role after the transition, perhaps in an advisory capacity? This is common among entrepreneurs. The longer they have been in control, the more personally attached they are and the more likely they will want to stay involved. This can gradually reduce the business's dependence on you and may make it easier to separate your identity from the business role you've held for so long. It can also help you gradually transition into retirement.

Plan for contingencies

Incorporate personal planning considerations into your succession plan. Have you prepared a Will and a Power of Attorney/Mandate? Who will run the business if you become incapable of doing so or pass away before the transition? Should you have a buy/sell agreement in place? Your tax planning may also include

discussion of family trusts, estate freezes and structuring your business succession to maximize the capital gains exemption.

Business planning quick tip

Family businesses have increasing rates of failure with each successive generation due to lack of realistic planning. Take a hard, honest look at the capabilities and interests of your younger family members. Are they really capable of taking over the family business? Do certain family members have more aptitude and interest than others? Or is someone outside the family a better choice? Once you've made your decision, start grooming your successor right away, giving them progressively more responsibility. As you approach your retirement date, give them the lead in planning the succession, which can improve the odds of a successful transition.

Benefits of a business succession plan

Business owners who implement a succession plan well in advance report significant benefits. The business enjoys improved financial stability as it moves through a well-planned and managed transition, and relationships with employees and family members also benefit. A large percentage of business owners feel that a succession plan has helped them provide for their family's future, and many report that they have been able to minimize their future tax liability and improve their business's financial stability. Those who acquired their business through succession agreed that succession planning yielded significant benefits and helped prepare them for their future as a business owner.

Please contact us for more information on successfully "handing over the reins" of your family business to the next generation.

Key decision 10: What will you do once you've retired?

Develop a plan to ensure your retirement is as successful as your business

Retirement planning requires you to consider a whole new lifestyle with new priorities and perspectives.

If you should ever think of retiring from your business, like many successful business owners, you may need help with retirement and tax planning matters. If your work has consumed much of your daily activities, the transition from this busy and demanding working life into retirement can be a challenge.

Give some thought as to how you and your spouse will spend your time in retirement and develop a plan to ensure that your new life will be fulfilling. This doesn't necessarily mean leisure and recreation. You could have an ongoing role in the business, become involved in a new one or work with a charity, non-profit organization or in the community.

Retirement planning requires you to consider a whole new lifestyle with new priorities and perspectives. A common misconception about retirement planning is the idea that money is the most important element and that you should focus your planning on creating after-tax cash flow. There are many other essential factors to consider.

Build an estate plan

If your business interests represent a significant part of your estate, have you thought about how the transfer of this wealth will affect you, your family, your relationships and your personal legacy? Family members may have played different roles in the business. Consider these differences when planning your estate and deciding how you will treat active and non-active family members; for example, equal versus fair treatment. In considering what income you will need, remember to provide for possible unplanned events. Try to be proactive in planning for an unforeseen event, such as a health crisis, and do your planning well in advance of your potential retirement date. Ensure you review your Will and Power of Attorney/Mandate on a regular basis so they continue to meet your estate planning objectives.

What are your plans after you exit your business?

As a business owner, the demands of running a successful business keep you very busy and engaged. Have you thought about how you want to spend your time after you retire? You may have a succession plan for your business, but do you have a plan to help ease the personal transition as well? It is a good idea to develop fulfilling new hobbies and interests while you're still working. You have left your mark on a successful business. Now you have an opportunity to leave your mark on your community and other areas of interest that are important to you.

Discuss your personal goals with your family and friends if possible. Working together to plan for the next phase of your life can be beneficial for everyone. If you have a spouse who has not been involved in the business, their transition may be different from yours. Remember to include them and develop a post-retirement plan together. This should include fine-tuning your personal finances for the last few years before you retire to ensure you're in good financial shape to proceed with your plans after you exit the business. Establishing clear personal goals will make this process simpler.

Financial considerations

There are a number of financial factors to consider as you plan your retirement. Tax and estate planning should be ongoing considerations throughout your working life to ensure that your plan continues to reflect your changing circumstances and is still on track to help you achieve your retirement goals. As a business owner, however, in addition to assessing your sources of retirement income, you will need to review your succession plan periodically to ensure that the projected proceeds from the sale or transfer of your business will last as long as your retirement does. It can be difficult to replace an income stream in later years. Remember to factor in the effect of inflation and consider strategies that can increase the value of the funds you will receive from the sale, well before your planned retirement date.

What are your sources of retirement income and when will they be available?

It's important to understand your sources of retirement income and how much recurring income will be produced by these and by existing income sources. These could include the CPP/QPP, OAS, RRSPs, proceeds from the sale of the business, income from an ongoing interest in the business, income from a new business, an IPP or an RCA.

Consider how to manage these sources of retirement income to maximize their efficiency. Where will you obtain funds if you have a cash flow shortfall? A common strategy is to withdraw funds from non-registered investments before redeeming funds held in tax-sheltered plans. This ensures you continue to defer paying tax on registered investments and preserves the power of tax-free compounding as long as possible.

Your RBC advisor can help you decide how to draw on your various sources of retirement income in the most efficient manner to minimize tax, maximize flexibility and make the most of the available tax credits. They can also help you identify the issues that are relevant for your situation and keep your long-term financial plan on track.

Plan your retirement early

Will you need all the proceeds from the sale of the business to fund your retirement? Ensure your succession plan has taken this factor into account. How will you convert the funds received from the sale into an income stream so it's available for you in retirement?

If you are transferring the business to family members, perhaps for little or no cost, your planning should incorporate this and the need to ensure that there will either be sufficient income from the business to meet everyone's needs or that other sources of income will be available.

At RBC we can help you design your financial plan, maximize your after-tax income streams and help you estimate how much wealth you will need for retirement. This will also help you determine whether you will have any surplus and, if so, how much. If there is a significant surplus, we can help you plan the transfer of this wealth to your intended beneficiaries in the most appropriate and tax-efficient manner.

Appendix 1: Special tax rules for farmers and fishermen

Make the most of special tax deferrals and exemptions

Our tax system provides special tax planning rules to meet the business succession needs of farming and fishing businesses.

Tax-deferred transfers to family members

If you own certain qualified farm or fishing property located in Canada that you use directly for your farming or fishing business, you may be able to transfer the property to your children on a tax-deferred basis during your lifetime, or when your estate is settled. This also applies when a family corporation or an interest in a family partnership is transferred from a parent to their child.

If your business qualifies for a tax-deferred transfer at the time of death or if you choose to transfer it during your lifetime, you may be able to postpone the payment of tax on any taxable capital gain until the child sells the property. You can also transfer such business property to your spouse or common-law partner during your lifetime and potentially postpone payment of tax on capital gains until your spouse decides to sell.

The capital gains exemption

A capital gains exemption may be available on the sale of your qualifying farm or fishing property, subject to some conditions. If your business meets the "ownership and usage" criteria, you may be eligible for the exemption. If you have previously claimed the exemption on a disposition of qualified property, the amount you claimed will reduce the amount of exemption available on the sale or transfer of your farm or fishing property.

If you transfer the property to a qualifying family member at its fair market value or at less than fair market value, there may be an opportunity to multiply the use of the capital gains exemption. Talk to your professional legal and tax advisors to determine whether these opportunities could work for you and your business.

Who will inherit/purchase the family business?

When deciding who will inherit your family farming or fishing business, there are many factors to consider. The choices you make can determine how the business will prosper in the years ahead, so take some time for discussions with family members. A large percentage of agricultural businesses consider it important to keep the business in the family, but relatively few family businesses survive to the second generation.

Do you intend to retire from the business and pass it on to the next generation during your lifetime, or on your death? If one of your children/grandchildren is to take over the business, ask yourself whether they have the business acumen, experience or desire to do so successfully. If there are several children in the family, are any other children likely to be involved in the ongoing ownership and management of the business, and, if not, are you making other arrangements for these children?

Have other family members made a commitment to the business, financial or otherwise, or a contribution that you should recognize?

Determining what is fair

Treating your children fairly does not necessarily require that you provide each of them with an identical inheritance. If only one of your children will inherit the business, and there are insufficient funds to provide an equivalent-sized inheritance to your other children, try to structure a division of property that is fair to everyone.

If there are children who are not involved in the farming/fishing business, have you already provided gifts to these children? For example, have you funded their university education? Can they inherit non-business assets? If any of them already hold an interest in the business, have you provided for this in the transfer arrangements? In some cases you may be able to structure more equivalent-sized inheritances for each of your children through the use of life insurance policies.

Depending on the circumstances, you may wish to transfer to the farming or fishing child only those assets that are essential for the economic viability of the business. To ensure the transfer is fair to all your children, consider the resale value of the assets transferred, the profit your business successor is likely to make and the contribution that person may have already made to the business.

Is the business profitable enough to support more than one household?

When you transfer the business during your lifetime, remember to take into account the financial position of all the households involved. If you are to receive a lump-sum capital payment, when will it be paid and will it involve indebtedness for the transferee household? What level of debt repayment can they tolerate and what rate of debt repayment can you accept that will provide you with adequate retirement income? Consider your household's lifestyle needs and retirement goals and factor in any financial commitments you have made to any children in the family, other than those you have transferred the business to.

Think about the transition period

Will you retain control of the business for a period of time? Consider the structure of the new business, for example, a partnership or a corporation. Will you continue to be involved, perhaps as a manager, and, if so, for how long? Give some thought as to how responsibilities will be divided in the new business. There may be matrimonial circumstances affecting the children who are taking over the business. Are there safeguards in place to prevent the family business from being adversely affected by a matrimonial dispute or marriage breakdown?

We can help you collect the information you will need in the decision-making process and review the critical issues of the business transfer to ensure your retirement goals remain on track. We can also work with you to invest the proceeds of sale in a manner that's consistent with your needs and goals and, if necessary, act as an objective third party to help you identify issues that may need to be addressed. Ask us how this kind of succession planning could work for your business.

Appendix 2: Incorporating your professional practice

Take advantage of enhanced tax and retirement benefits

There are significant differences between a professional corporation and other corporations.

If you are a professional such as a doctor, dentist, lawyer or accountant, you might consider the advantages of incorporating your practice if you haven't already done so. Incorporation is permitted by certain professional regulatory bodies, and may provide potential tax savings and tax-deferral benefits. It may also enable you to take advantage of enhanced retirement plans such as IPPs or RCAs.

Characteristics of professional corporations

There are significant differences between a professional corporation and other corporations. A professional corporation is generally subject to the rules and guidelines of the regulatory body governing its profession. These include restrictions on the name of the professional corporation and who may be named as a voting shareholder. For example, in some provinces and territories, only members of the same profession can be voting shareholders of a professional corporation. Generally, the officers and directors of the corporation must also be voting shareholders. Before deciding to incorporate your practice, make sure you understand the regulatory guidelines applying to your profession in your province/territory.

Advantages of professional incorporation

There are a number of potential benefits to incorporating your professional practice. You may be able to:

- Enjoy potential tax savings due to the reduced federal and provincial/territorial corporate tax rate that applies to active business income
- Benefit from the tax-deferral opportunities of the corporate taxation structure and use the additional funds in the corporation to pay off debt, purchase capital assets, acquire investments or fund an insurance policy
- Take advantage of the capital gains exemption available on the sale of shares of a professional corporation, provided certain conditions are met
- Achieve potential tax savings through a number of income-splitting strategies, depending on your province/territory of residence
- Limit your commercial liability to trade creditors
- Choose from flexible remuneration options depending on your province/territory of residence

Planning for retirement

Professional incorporation provides retirement benefits not available to sole proprietors or partnerships, including the ability to establish IPPs and RCAs. These retirement savings vehicles can greatly enhance your retirement benefits and potentially provide creditor protection.

We can provide more detail on how these retirement savings vehicles work and how they can form part of your comprehensive retirement plan.

Business planning quick tip

There are several strategies incorporated professionals can consider to reduce taxes. However, there is at least one tax strategy available to unincorporated professionals – "cash damming". With cash damming, you convert the interest on your personal debts to a tax-deductible business expense by using the revenue from your business to pay off your personal debts. You then use a separate line of credit or other loan facility exclusively to pay your business expenses. If you would like to learn more about how this strategy works, please ask us for more information.

Considerations

In addition to the many advantages offered by professional incorporation, there are some considerations to bear in mind. The costs of establishing and maintaining a professional corporation can be higher than those of a sole proprietorship. There are greater tax filing and compliance obligations. You can't use business losses to offset your income from other sources. And you may also have to pay a health tax levy when your corporate payroll exceeds a certain level (depending on the province/territory).

Creditor protection

If you decide to incorporate, you should also keep in mind that a professional corporation can only protect you against business creditors and not personal liability for professional negligence. Consider investing in malpractice insurance and other creditor protection strategies such as setting up an IPP inside the corporation.

We can help you implement several strategies made possible by professional incorporation, including IPPs and RCAs. Please contact us for more information.

Summary

As a business owner, your success depends on your ability to make smart business decisions. Some of the most important decisions you will make concern a range of tax, retirement and estate planning issues, some of which we have highlighted in this guidebook. By making the right decisions, you can maximize the tax advantages available to you, put strategies in place to grow your business and ultimately ensure a smooth transition into a well-funded retirement. If you would like to explore any of the issues discussed in this guidebook in greater detail, we would be pleased to assist. Please contact us for more information.

For more information, speak with an RBC Wealth Management advisor or visit rbcwealthmanagement.com

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