



As Vice President, Donor Engagement at Calgary Foundation, Laily Pirbhai's extensive charitable gift planning knowledge has earned the Foundation a place at the forefront in philanthropic services.

Business succession planning and philanthropy

LAILY PIRBHAI

Philanthropy holds the world's largest family businesses together.

Don't believe me? A 2015 survey found that 81% of the world's largest family businesses practice philanthropy. Need more proof? In this issue of *Advice to Advisors*, we invite you to review the findings of a follow-up EY (Ernst Young) study that analyzes the how and why of business philanthropy. (Spoiler alert: It's all about creating impact by defining family values and engaging the next generation in the process, something that **Calgary Foundation** believes in deeply.)

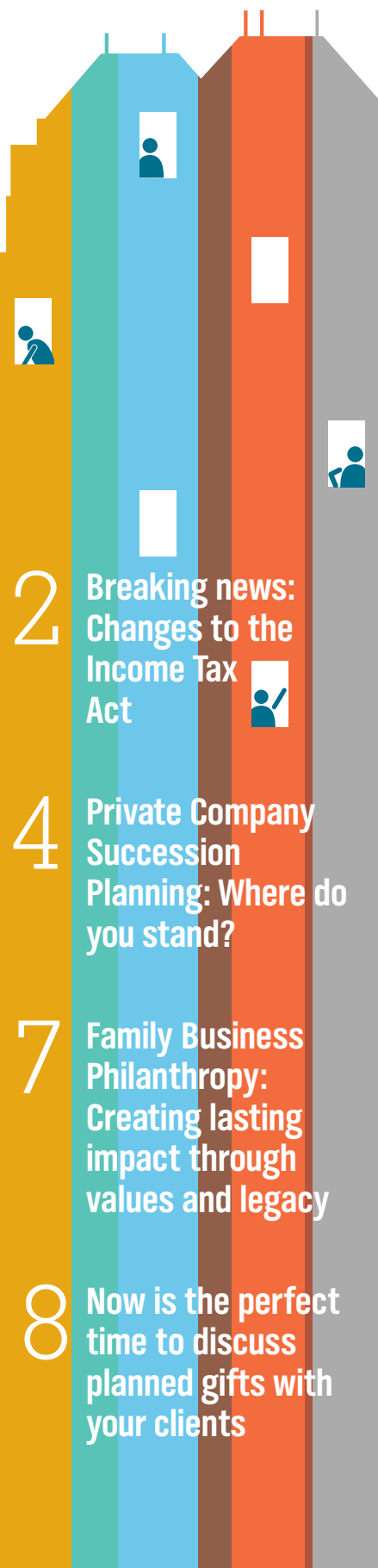
In her recent article, **Sara Neely** notes "...it's important for the advisor to discover the motivations to facilitate the right gift at the right time," whether it's "when a business is sold, an inheritance is received, or a legacy gift is planned." As baby boomers retire, a new generation will be taking over private company ownership. But, our review of a **Canadian Financial Executives Research Foundation** (CFERF) study shows that only 40% of Canadian

private companies have a business ownership succession plan in place. Business planning and philanthropy can be two parts of the same conversation between a professional advisor and their client.

Succession planning may include mergers and acquisition, agreements with family or employees or even initiating a wind-down of the business. Included in this issue, is an article by **DeWayne Osborn**, revisiting the important role of tax planning in these situations as a means to enable entrepreneurs to optimize their philanthropic giving.

And, speaking of tax! As we put the final touches on this issue of *Advice to Advisors* we await Finance's final decision on draft legislation amendments to the *Income Tax Act* announced last July. We appreciate DeWayne taking the time to do a Q & A regarding his thoughts on the proposed changes in relation to their impact on gifting.

Feel free to share this publication with your peers, clients and development professionals in the charitable sector. Enjoy!



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B R E A K I N G **NEWS**

Changes to the Income Tax Act



October 2, 2017 is the deadline for submissions on the draft legislation to the *Income Tax Act*, as announced in mid-July. The amendments address, what the current government perceives as unfair tax benefits afforded to private corporations and their shareholders. Specifically, the proposed changes seek to limit income splitting (a tax strategy that private business owners have long used to manage their overall family tax position), the multiplication of the lifetime capital gains exemption, the conversion of income into capital gains, and the deferral of passive investment income earned through a corporation. The majority of the proposed changes are not expected to come into effect until 2018.

Changes to the Income Tax Act

CF: *Tax planning strategies involving private corporations may be affected as a result of proposed changes to the Income Tax Act. As a valued and accredited professional advisor to Calgary Foundation, can you provide your opinion on some of these anticipated changes?*

DO: Charities and other interested parties must take the “high” ground and defend planned gifting and the impact these proposals might have on it. For example, no comment is necessary with regards to the Tax on Sprinkled Income (TOSI) recommendations as they have nil impact on planned giving. Also, it appears that Finance seeks to disallow the allocation of the non-taxable portion of the gain on passive income to the Capital Dividend Account (CDA) – except for certain circumstances. We must ensure that charitable gifting is one of those circumstances. The government also proposes to apply a new tax on the capital gains when the private company disposes of its publicly traded securities derived from passive income. Similarly, we must confirm that the zero inclusion rate for private company gifts of publicly traded securities remains zero. We must also seek clarification that the provisions of 84.1 only apply to “consideration received” transactions and thus will not apply to charitable gifting in general, and in particular, to private foundations.

*(Note: In this issue of **Advice to Advisors**, DeWayne’s article, “Now is the Perfect Time to Discuss Planned Gifts” uses a strategy of avoiding highly taxed dividend income in favour of capital gains in a charitable context. It could be argued that a private foundation is a non-arm’s length corporation, hence 84.1 might apply.)*

CF: *What about concerns that gifts of privately held securities could be impacted?*

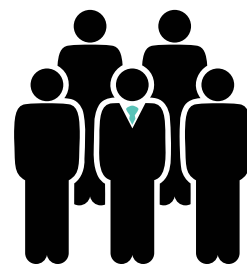
DO: Privately held shares derive their value from the underlying assets in the company or the terms of a shareholders’ or similar agreement. Proper valuation will address that concern.

CF: *There is also concern that these provisions will reduce the private business owners wealth and/or impact a donor’s ability to donate from the personal corporation.*

DO: My view is that, if enacted, the proposed legislation will effectively remove the unintended tax incentives that appear to be driving passive investments by private companies. The shareholder will still invest retained profits (maybe more personally than corporately) and if the amount gifted from personal corporations is reduced, personal giving will likely compensate for that reduction. The wealth will not disappear. It will just be switched to a different donor. Charities may still get the property in the end because, as we all know, you cannot take it with you when you die and taxation is supposed to be way down the list of priorities when donors are contemplating planned gifts.

Finance believes that allowing vast wealth accumulation in private companies violates the basic tenant of the Canadian tax system – fairness. Passive investments should be in the hands of individuals and if not, should be taxed the same. What we are seeing here is a repeat of a very common theme: tax professionals have over-utilized provisions of the *Income Tax Act* in a manner that violated the spirit and/or intent of the legislation, and such practices have finally hit the “radar” of CRA and Finance is reacting.

Private Company Succession Planning: Where do you stand?



Excerpt from the 2011 Canadian Financial Executives Research Foundation (CFERF) survey, sponsored by Grant Thornton.



Private businesses face an uphill battle regarding ownership transition, even though many have either started the process or are considering it. But time is running out quickly as a whole generation of baby boomer entrepreneurs has reached or is quickly approaching retirement age. That translates into a large number of businesses that may be negatively impacted by an unplanned change in ownership. But according to financial executives participating in a Canadian Financial Executives Research Foundation (CFERF) study, the process is unlikely to be smooth sailing. The research findings indicate that succession plans at most companies are murky at best: only 4% of Canadian private companies have a clear business ownership succession plan in place.

As company owners age, along with the rest of the population, many entrepreneurs are finding they are ill-prepared for the inevitable ownership transition that lies on the horizon. The risks of this lack of foresight are enormous. By not having a plan in place, owners may fail to realize the full value of their business during the exit process or may take a significant tax hit – or both. For instance:

- 60% of respondents (all financial executives employed at private enterprises) said that no formal valuation of the business had taken place.
- With regards to estate planning, fewer than half of respondents said that owners of the company were satisfied that their succession planning objectives would be achieved through their estate plan. Only half said their company owners had an up-to-date Will in place and adequate pension or retirement arrangements.
- Less than half of owners knew how much personal income tax would be triggered upon his or her death.

Other risks identified in the study include alienating potential successors – outsiders, senior members of staff, or family members – and putting the business as a going concern at risk. Families may be torn apart when there is a lack of clarity on succession. It may even be difficult to obtain long-term financing if lenders perceive there has been inadequate business planning. These findings should trigger a call to action in a country which relies on small and medium-sized businesses to generate as much as half of Canada's gross domestic product.

"I think that every company needs to have a succession plan that is based upon multiple scenarios, be it exit through sale, buyout, death or lack of interest. The plan has to go beyond the president or the C-suite – it has to go right down to anybody who has any ground value to your company at all, and you integrate that in."

Don Miller – CFO, Blast Radius Inc.

The study also pointed to challenges specific to family-run businesses, which employed half of the survey respondents. While the majority of family businesses had appointed designated successors, the survey indicates that some of those successors did not go through any training or relevant education to prepare for their future responsibilities. Only half of the financial executives respondents employed at a family business where a successor had been identified believed the successor was ready to take on the challenge of running the business. This red flag is a huge concern for businesses relying on a successor who lacks the personal drive and commitment, let alone the skills, training and education, to take it over.



The research looked at situations in which some family members chose to retain an ownership stake while remaining uninvolved. The findings show that slightly more than half (55%) of survey respondents employed at family businesses said there were clear plans as to how family members not employed by the business would share in the profits, compared to family members working in the business. In addition, nearly 60% of respondents said there were no formal processes or mechanisms in place to address and minimize potential family conflicts.

For family members not interested in the business, an exit strategy that would allow potential successors to take over through a buyout requires a meticulously thorough, accurate and fair company valuation. Study participants indicated that CFOs were uniquely positioned to play a role in stick-handling the process; helping the owners in understanding the valuation process, and in keeping owners grounded and their expectations reasonable. It was noted that the CFO can also play a critical role post transition as a primary point of contact for new owners.

The softer side of succession planning

Succession is just like any other change: many find it difficult to accept. Yet, it is the challenge facing CFOs or senior financial executives managing a transition. For the financial executive who plays a support role for the owner facing such a transition, there are obvious technical and financial issues related to succession planning - estate planning, tax minimization strategies and wealth preservation are but a few. Some of the greatest challenges are human or emotional issues, areas which the financial executive may not be trained or equipped to deal with. Some of the issues on the softer side of succession include:

- Lack of common vision between interested parties
- Lack of a communication framework for all parties involved
- Difficulty dealing with conflict, particularly around sensitive issues
- Unwillingness for all involved parties to support

the succession planning process, including owners ambivalent about planning for transition and/or reluctant successors

- Managing the business profitably through change

These issues, although not directly financial in nature, can have a very real impact on the numbers side of the business if left unresolved. This can create a ripple-effect throughout the organization and ultimately boomerangs to the CFO and the finance team.

Many businesses haven't started thinking about succession, or may have decided the topic is too difficult to deal with, or can't figure out where to begin. These are all reasons why succession planning has the reputation of being overwhelming. What may appear to be a linear step-by-step process may be better viewed through a holistic approach. Each organization is unique and is best viewed differently on a spectrum of succession planning readiness compared to other organizations.

The unique aspects of every organization, together with the constant change and flux in the business environment, will have an impact on decisions made regarding succession planning and the eventual transfer of business ownership.

Tax and Estate Planning

The importance of tax planning is well known. As one participant aptly put it, "every deal has three parties: the buyer, the seller and the government." "The latter's involvement tends to lead to one of the more typical pitfalls of succession planning, which is allowing tax issues to take centre stage too early on in the process," explains Paul Coleman, a partner with Grant Thornton in Toronto. "If a tax planning perspective dominates, the tendency is to keep the valuation of the business as low as possible. But other factors have to be considered in estate planning, and the lower valuation may not benefit all the parties in a succession. There may be other ways to pass the company on to the successor(s) in a tax efficient manner (through the use of a trust, for instance). I'm a firm believer that you put the tax piece at the end

Private Company Succession Planning: Where do you stand?



once you have fashioned all the other key decisions out,” Coleman said. “Make sure that the tax people have their role, but they don’t drive the process.”

Three-quarters of the respondents had sought professional tax advice with regards to the tax implications of a future transfer of ownership, and most said the owner had implemented a formal tax strategy to minimize the potential liability of income tax upon death. However, less than half knew how much personal income tax would be triggered upon his or her death. Most respondents said their companies had operations in more than one jurisdiction in Canada, and most were also operating outside Canada – two factors alone that can add to any tax burden upon death.

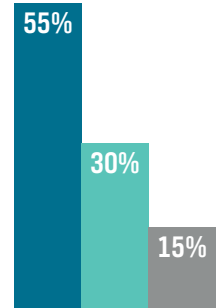
With regards to estate planning, fewer than half of respondents said their company owners were satisfied that their succession planning objectives would be achieved through their estate plan. Half said their company owners had an up-to-date Will in place and had adequate pension or retirement arrangements.

“I was involved with two very different succession planning projects. One being a very successful transition, and one was not. In the successful situation, a personal succession coach helped navigate the process, take a holistic approach, and be a facilitator of the various dynamics at play. The focus was not just on tax and estate planning. Instead, the succession coach was a generalist who was independent and impartial; helping to facilitate a broad range of areas and quarterbacking the overall planning from both the dynamics of the demographics – the emotional, passionate – as well as the financial aspects.”

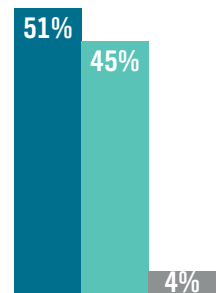
- **Vicki Nishimura** – Vice President and Corporate Controller, Prism Medical Ltd.

Estate Efficiency

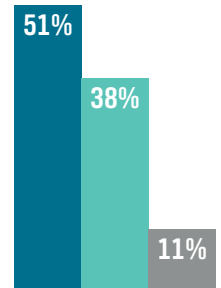
Has the owner(s) implemented a formal tax strategy to minimize the potential liability of income tax upon death?



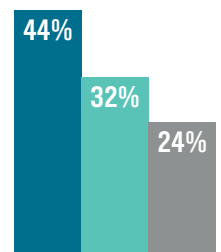
Does the owner(s) have adequate pension/retirement arrangements?



Does the owner(s) have up-to-date Will(s) in place?



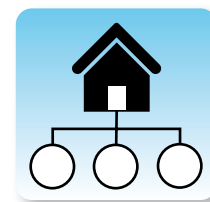
Does the owner(s) know how much personal income tax would be triggered upon his/her death?



Yes Don't know No

The survey of more than 100 financial executives was conducted in July, 2011, by CFERF, and insights were gathered via an executive research forum held by video conference in Toronto and Vancouver. The research study was sponsored by Grant Thornton LLP. The full report is available [here](#)

STUDY: FAMILY BUSINESS PHILANTHROPY: creating **lasting impact** through **values** and **legacy**



EY Global & Center for Family Business
at the University of St. Gallen



Family business philanthropy is a vital global contributor to education, health and humanitarian aid.¹



In the US, corporations and foundations, many of which are family-owned, donate over US\$67b per year



In the UK, the top 100 family businesses and foundations contribute £908m per year to societal causes



In Germany, family foundations donate around €490m every year to philanthropic projects

In early 2016, EY in collaboration with the Center for Family Business at the University of St. Gallen conducted a survey to examine what drove families to engage in philanthropy as well as how family business philanthropy was managed and evaluated. The results of the study can be highlighted in five summary findings:

1 Family businesses apply a portfolio approach to philanthropy

Providing services to the community is the most prevalent form of family business philanthropy, followed by monetary contributions to charities and then social impact investing. In Canada, 57% want to support projects in their community, while 43% prefer to pick a cause, regardless of location.

2 Family businesses have a holistic perspective centred on the founder's values

The expression of family values develops over time into a strong instrument to bring the family together.

3 Philanthropy is organized through both family and business

Around two-thirds of family business owners organize their philanthropy through a family-specific vehicle, such as a family foundation, trust or office.

4 Government support is a decisive factor in family business philanthropy

In countries where owners perceive that the laws promote tax benefits for giving, family businesses are more likely to engage in philanthropy.

5 Family businesses are keen on effective solutions

On average, 56% of all family business owners personally oversee the progress and effectiveness of their philanthropic projects.

This large-scale survey, including 525 responses from 21 countries, was conducted by EY in collaboration with the Center for Family Business at the University of St. Gallen between January and February 2016. Download full survey results [here](#).

¹ Feliu and Botero, 2016; National Philanthropic Trust, 2013; Pharoah, Jenkins, and Goddard, 2014.

Now is the Perfect Time to Discuss Planned Gifts with Your Clients



DEWAYNE OSBORN

This article was first published in April 2013, however the content remains “evergreen” when revisited in the context of the latest proposed amendments to the Income Tax Act. The practical examples provide valuable charitable gifting tools for any Professional Advisor and become increasingly relevant as Calgary’s boomer generation of entrepreneurs plan their retirement.

Over the past decade, there has been a series of significant legislative events that I would call the *perfect storm* of opportunity for your clients to make a significant charitable gift to their favourite charity. While legislative changes alone should never be sufficient grounds for any charitable gift, for a philanthropically-inclined client that is facing certain financial situations at this stage in their life, a little pre-planning can save hundreds of thousands of taxation dollars while making their philanthropic dreams come true.

What types of situations am I referring to? Over the past year, there seems to be an increasing number of our clients, High Net Worth (HNW) and otherwise, undergoing substantial life changes. This would include the selling of their business or retirement, selling off assets no longer needed, loss of a spouse, and so forth. These situations often generate significant tax issues for the client, as well as situations where the philanthropic client can address some, or all, of their tax issues by using charitable gifting.

Estate planning using the ACB Pipeline

When this article was first published in 2013, the highest personal rate of taxation in Alberta was 39%, and the highest non-eligible dividend tax rate was 29%. Today, those same rates are 48% and 41.29%, respectively. Today more than ever, advisors are planning how to structure their client's taxable income into capital gains while avoiding dividends and salaried income. For example, a common estate planning problem facing HNW business owners is how to tax effectively extract themselves from their ownership in the business. Based on a review of the pipeline strategies currently promoted by tax advisors, the common theme seems to involve creating capital gains and eliminating the deemed dividend that occurs at time of the death of the shareholder.

If the philanthropically-inclined client is comfortable with such levels of estate planning, there are opportunities to make significant gifts and avoid *both* taxes without the same concern that CRA might challenge the strategy at a later date (as with uses of the pipeline strategies). Let us take a look at some common promoted strategies and adjust them for a charitable gift.

Fact pattern: Donor A is an uninsurable 75-year-old widower. He is comfortable with relatively sophisticated tax planning and completed an estate freeze some time ago. He currently owns \$2 million of preferred shares in PrivateCo with an adjusted cost base (ACB) and paid up capital (PUC) of nil. He has substantial other assets and his personal tax rate at death will be 48%, and his dividend rate will be 41.29%. Donor A does not like to pay any more tax than absolutely necessary and very recently determined that his children were no longer in need

of money from his estate. For simplicity, assume other tax savings measures such as capital dividends and loss carry backs are not available.

Prior to July 2017, Donor A's advisor might have presented a strategy used many times before. The strategy is known as the "ACB Pipeline" (or simply, "pipeline") and it's primarily designed to eliminate the deemed dividend when shares are redeemed by the company.¹ Table 1 shows what the advisor plans to propose to Donor A:

Facts	No Estate Planning	Pipeline Strategy
FMV* of Shares	\$2 million	\$2 million
ACB	\$0	\$0
PUC	\$0	\$0
Capital Gain	\$2 million	\$2 million
Deemed Dividend	\$2 million	\$0
Tax on Gain @ 48%	(\$480,000)	(\$480,000)
Dividend Tax @ 41.29%	(\$825,800)	\$0
Total Tax Payable	\$1,305,800	\$480,000

* Fair Market Value

Table 1

Generally speaking, a new company will be formed (NewCo) from language in his/her Will. NewCo will purchase the PrivateCo's preferred shares from his estate using a promissory note and nominal value shares. Upon winding up, NewCo would own PrivateCo, and once the shares are converted to cash, the promissory note will be paid to the estate on a tax free basis. Therefore, the only tax Donor A will have to pay is on the \$2 million capital gain, which is projected to be \$480,000 (\$2 million X 24%). Before proceeding, the advisor will make sure that Donor A is comfortable with CRA's concern with regard to this strategy.²

¹ The intent to this article is to not promote any particular planning strategy. Rather to encourage advisors to consider altering existing and well understood planning strategies to include charitable giving.

² CRA has commented that removal of assets using this strategy could trigger ITA 84(2) thus making the dividend taxable. The final decision on the feasibility of this or any other tax avoidance strategy will ultimately rest with the courts.

Now is the
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Planned Gifts
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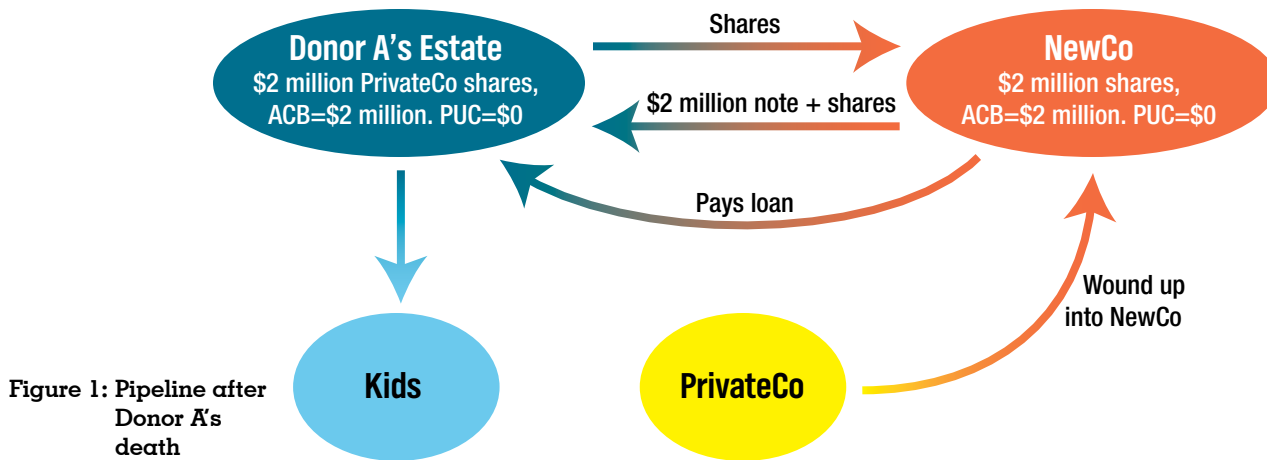


Figure 1: Pipeline after Donor A's death

Estate Planning Using a Foundation "Pipeline"

During the meeting, Donor A realized two things:

1) that the size of the gifts left in his/her Will many years ago were no longer sufficient, and 2) the donor remembered that some foundations (e.g. Calgary Foundation) will accept private shares with a ready redemption strategy in place. Donor A mentions these two things to his/her advisor and they devise the plan shown in Table 2:

Facts	No Estate Planning	Foundation Strategy
FMV of Shares	\$2 million	\$2 million
ACB	\$0	\$0
PUC	\$0	\$0
Capital Gain	\$2 million	\$2 million
Tax on Gain @48%	(\$480,000)	(\$480,000)
Deemed Dividend	\$2 million	\$2 million
Dividend Tax @ 41.29%	\$825,800	\$0
Donation of Shares	NA	\$2 million
Tax Credit from Gift*	NA	\$1,080,000
Total Tax Payable**	\$1,305,800	\$0

Table 2 Notes: * \$2 million X 54%

** The tax credit eliminates the tax on the gain leaving \$600,000 in tax savings for other income.

3 A qualified appraisal be required to verify the fair market value of \$2 million.

4 If the gift is deemed from his Graduated Rate Estate, Donor A will be able to use the \$600,000 in tax savings on his/her final two tax returns, or any of the first five estate tax returns, or both!

5 The Foundation was one of the five charities that Donor A wished to support. The written direction is commonly referred to as a Deed of Gift.

6 Any Refundable Dividend Tax on Hand (RDTOH) in PrivateCo could be refunded by the taxable dividend paid to the Foundation.

Instead of striking a NewCo, Donor A makes a bequest of all \$2 million of his preferred shares to the Foundation.³ The Foundation will issue a tax receipt for \$2 million and the resulting tax credit will wipe out the \$480,000 in tax on the capital gain, as well as allowing an additional \$600,000 in tax savings to be extended to other income on Donor A's final tax return.⁴ PrivateCo will redeem the shares from the Foundation, which will provide the \$2 million in cash to be split amongst the charities as per Donor A's written direction to the Foundation.⁵ The Foundation is exempt from income tax, hence does not pay tax on the deemed dividend.⁶

The end result: Donor A does not pay any tax on the disposition of his preferred shares and the charities he wanted to support will have meaningful gifts to do their work. Given that Donor A did not receive consideration for making the gift and the charities were at arms length to him, this strategy should conform with the tax reforms proposed on July 18, 2017. However we will not know until the comment period expires and the final wording is proposed.

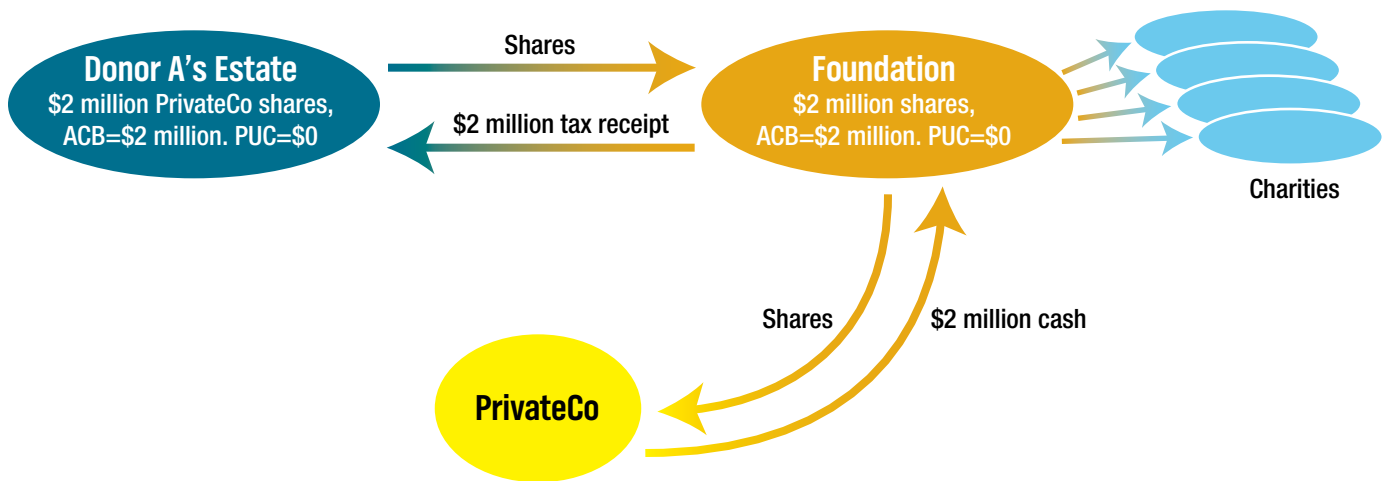


Figure 2: Foundation "Pipeline" Strategy after Donor A's death

Private Foundation "Pipeline"

If the client has a redemption strategy in place for his or her preferred shares of their HoldCo, the aforementioned foundation pipeline strategy works very well using a private foundation as the recipient charity. Everything as illustrated in Figure 2 is exactly the same, except the foundation is controlled by Donor A's family. It is critically important that Donor A have a ready redemption strategy for the shares to satisfy the forced disposition requirements of the Excess Business Holdings (EBH) regime on the newly formed private foundation. Besides some special reporting requirements for transactions with certain persons, this legislation also requires the disposition of any class of shares owned by a private foundation and or persons not at arm's length with the foundation when the combined holdings exceed 20% of the total share class. Note that Excess Business Holdings does not apply when the private foundation owns 2% or less of any share class.

Why would one consider using a private foundation rather than a public one? As mentioned above, it has never been simpler to administer a private foundation than now. With the removal of the 80% spending requirement for tax receipted gifts, donors have the flexibility to decide how, how much, and when they will support the charities of their choice. Secondly, many public charities are unable to fund their activities the way the donor wishes. For example, the donor may not want to invest in a perpetual endowment, but would rather have the funds used over a period of time. This "diminishing fund" concept is not well received by most endowment-based charities. (Note: Calgary Foundation has diminishing funds and other non-endowment gifts.) Thirdly, the donor can continue using financial planning services advising for their new account – the private foundation!

While no consideration was received for the shares, the non-arms length relationship between Donor A and the private foundation might get caught up in the July 18, 2017 proposals. We will have to wait to see the final wording of the legislation

Gift of existing insurance through a holding company

Here is a real world situation that might be applicable to your client base. The client is a 72-year-old recent widower that has several holding companies and other commonly used tax structures. As with many high net worth clients, he also has several life insurance contracts owned both personally and corporately. The client has been making charitable donations for years.

Recently, the client sold some of the corporately-owned leisure property and had incurred significant capital gain that would generate \$300,000 in taxation. He also felt that he no longer needed one of the corporately-owned life insurance contracts and was prepared to stop paying the premiums. The contract was a whole life policy that guaranteed to pay a death benefit of \$2.5 million provided the \$16,000 annual premium was paid. The premium was based on a guaranteed internal rate of return of 4% in the policy.

In discussion with his advisor, it was recommended that the client donate the insurance policy to resolve the tax issue at hand and to leave a significant gift to three charities he had supported for decades. An actuary assessed the value of the contract at \$1,070,000 on the condition that the recipient charities guarantee that the premiums would be paid.⁷ By assigning the contract to Foundation A, the client eliminated the \$300,000 in tax from the sale and had an additional \$277,800 ($\$1,070,000 \times 54\% - \$300,000$) in tax savings to use in the current year OR over the next five years. Thanks to changes in the disbursement quota (see sidebar), Foundation A was able to issue the large receipt because it was not required to spend \$856,000 in the next year ($\$1,070,000 \times 80\%$) and Foundation A agreed to pay the annual premium as well as 1/3 of the death proceeds received to Charities B and C. A true win-win scenario for all.

On March 4, 2010 Finance removed the requirement that charities had to spend 80% of the value of receipts it issued in the previous year. This annual spending requirement is referred to as the disbursement quota.

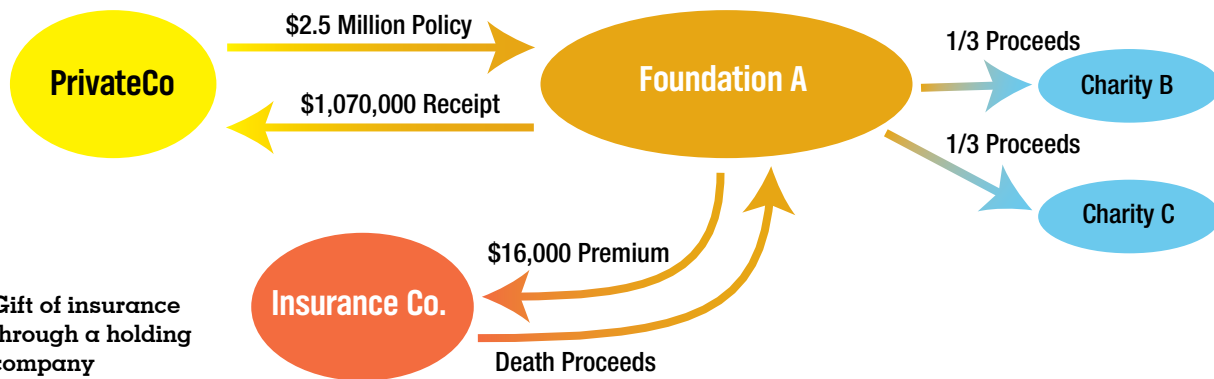


Figure 3: Gift of insurance through a holding company

⁷ Note that prior to 2007, the FMV of the gift would = the cash surrender value of \$11,000.



If you have any questions regarding the content of this article, feel free to contact **DeWayne Osborn** directly at 1-800-310-4664 ext. 211 or dosborn@Cardinal.ca

If you would like more information on the philanthropic services, family legacy planning options and approaches to planned giving available through Calgary Foundation, please contact **Laily Pirbhai**, Vice President, Donor Engagement at lpirbhai@calgaryfoundation.org 403-802-7718