Estate Planning for Business Owners

You have built a business plan for success. Now, it's time to build an estate plan for succession.

When starting a business, most people focus on the tasks required to get the business off the ground, such as business plans, marketing, sales, etc. Many business owners, however, often neglect the importance of creating an estate plan. You probably created your business with the goal of being profitable. It is equally important to plan for maximizing and distributing that accumulated profit when you die. In this article, we will discuss estate planning options for business owners by examining three types of business structures: sole proprietorship, partnership and corporations.

1. Sole Proprietorship

A sole proprietorship is a business owned by one person personally where there is no legal distinction between the individual and the business. The owner owns the assets, takes on the liabilities, and makes profits, all in his or her personal capacity. Regardless of what you do, if you run the business personally, you need to understand how this can impact your estate and make a plan so your loved ones are not left untangling a mess.

What is Your Plan?

How would you want the business handled? Does it make sense to wind it up or keep it running? Should it, or could it, be sold?

Consider if there is any value to the business without you. For example, a consulting business is not likely to have much value without its consultant. On the other hand, a store, whether online or in person, might be carried on after its owner dies. If there is value to the business after your death, consider if anyone might be available to operate it. The question is really about finding someone who is able *and willing* to step into your shoes. Otherwise, consider if it makes sense to sell the business altogether.

Do You Have a Will?

You now have a plan in your mind. The next step is to make sure that your plan will be properly laid out in your Will. In your Will, you can appoint someone you trust as your Executor to carry out your instructions on what you want done with the business, considering the questions above.

In Ontario, if you die without a Will, your wishes about the business may not be carried out. Without a Will, no one is legally authorized to act on your behalf and deal with your business unless someone, possibly your friend or family, applies to the court to be appointed as "Estate Trustee Without a Will". Further, without a Will, there are no default instructions left about your business. Your Estate Trustee has the obligation to divide your estate, including your business, among your next-of-kin according to the laws of succession. There may be conflict over who should apply to be appointed as Estate Trustee and uncertainty over what to do with your business.

Do You Have Business Assets?

If you run your business personally, you own the assets and take on the liabilities personally. That means you are personally responsible for leases and any personally signed contracts for bank accounts, supplies, sales contracts, and the like.

Do you have separate online accounts (such as Instagram, Twitter, or Facebook) for your business? Do you run your business under a separate registered business name? Even if these accounts are for your business, you are still personally responsible for accessing and maintaining them. Any parties that you have contracts with, including website platforms, will need to be notified that you have died. Contracts, including online accounts, might be valuable. Think of a lease in a prime neighbourhood or Instagram or Facebook accounts with many followers.

Someone will need to evaluate all your contracts and decide if any are worth continuing, selling or assigning, or if it is better to simply terminate them. Any profits from your business after you die will form part of your estate.

As an aside, each website platform has its own rules for how to deal with an account when the user dies. The rules are not always consistent. Leaving it to chance to decide who will manage these accounts risks a long, complicated process to deal with them, and risks losing any value the accounts may have.

With a Will, you can decide who makes decisions about your business contracts, and how to distribute the profits, contracts and/or assets from your business after your death. If you do not have a Will, there are default rules to distribute your estate, but these defaults only include specific family members and might leave out other people or charities you want to benefit. Also, if you die without a Will, the time and process to get access to your online accounts or digital assets would be longer and complicated.

Do You Have a Business Account with the CRA?

If you collect and remit Harmonized Sales Tax (HST), someone will need to close your HST account and file your final HST return. Someone will also need to file your final personal income tax return, close your business number, and close any other Canada Revenue Agency (CRA) business accounts once all returns are filed.

The only way to pre-select someone to deal with these accounts and taxes when you die is through a Will. Otherwise, no one is authorized to deal with the CRA. This can cause filing delays and risks interest charges and late filing penalties.

2. Partnership

A partnership is another type of business ownership in which two or more individuals carry on business together with an intention to profit (where the business is not incorporated).

There are different ways to structure a partnership. In its simplest form, all the partners own all the assets, take on all the liabilities, and share in all the profits, equally. While different partnership structures may have specific issues, the general rules discussed below will apply to any form of partnership.

Operating a business as a partnership means you need to consider more than just your family, friends and charitable interests when you make your estate plan. You also need to consider your business partners.

Do You Have a Partnership Agreement?

In terms of succession planning for partnerships, the most important tool is a partnership agreement.

In Ontario, the *Partnerships Act*, R.S.O. 1990, c. P.5 (the "Act") creates a set of default rules that apply to all partnerships. Many of these default rules can be modified by an agreement between the partners, often called a "partnership agreement". A partnership agreement should be in writing and signed by all the partners. Sometimes, an agreement can be implied – but this can be very expensive because it means you are asking a court to decide on your rights instead of negotiating them yourself. You also lose an important element of control. Getting it in writing up front is the safer way.

Without a partnership agreement, implied or in writing, you are subject to the default rules that apply under the Act, both when you run the business as partners and after you die. This can have unintended consequences both for the business and your estate.

For example, under the Act, a partnership is automatically dissolved between all partners if one partner dies (even if there are multiple surviving partners). This is a problem if you want your heirs to continue in the business. It could also be a problem for your remaining business partners if you all intended the business to keep running after you die. Only a partnership agreement can avoid this rule and provide for the partnership to continue.

The Act also creates default rules for distributing business property and profits. Most importantly, the default is to divide profits and property equally among partners, both while the business is running and when a partner dies. This is a problem if you put in more work or capital and expected a larger share of the profits or property. It is also a problem if your partner(s) expected a larger share and take your estate to court to get it. Again, only a partnership agreement can avoid this rule and provide for the distribution you and your business partners expect.

A partnership agreement can modify many other default rules. This means it is important to make sure the agreement truly reflects your business operations and expectations, both while you are running the business and after your death.

Do You Have a Will?

Once you have the partnership agreement in place, your estate plans need to reflect and work together with the partnership agreement. So, the next important question is – *Do you have a Will?*

By making a Will, you ensure that your Executor will step into your shoes to act on your behalf and you give your Executor instructions regarding your interest in the partnership.

For example, if the partnership agreement allows your Executors to designate your replacement in the partnership, then your Will should provide them with guidance on this if you have someone in mind.

On the other hand, if the partnership agreement provides that your interest will be bought out at fair market value, you need to take into account the incoming cash (and tax liability) when deciding how to divide your estate.

As we discussed above, if you die without a Will in Ontario, no one is legally authorized to act on your behalf and deal with your interest in the partnership until someone is appointed as "Estate Trustee Without a Will" by the court. Therefore, without a proper plan in place, your family would go through this costly, lengthy and complicated court proceeding.

3. Corporations

Lastly, we will consider estate planning for an individual who owns shares in a privately-held corporation incorporated under the *Business Corporations Act* (Ontario) (the "OBCA"). Similar considerations apply to an individual who owns shares in a privately-held corporation incorporated federally under the *Canada Business Corporations Act* (the "CBCA") but operating in Ontario.

Do You Own a Privately-Held Corporation?

A corporation is a separate legal entity created when its Articles of Incorporation are filed with and approved by the relevant government body. The corporation's board of directors manage (or supervise the management of) the business and affairs of the corporation and are generally elected to do so by the shareholders. Directors can sometimes delegate their management duties to officers (such as the Chief Operating Officer, Chief Executive Officer, and so on). The corporation essentially "acts" through the actions of its board of directors and officers.

Investors who wish to share in a corporation's profit can purchase its shares. A privately-held corporation cannot sell its shares to the public. Nevertheless, you might own shares in such a corporation because you founded the business, either alone or with others, or under special exemption rules for certain types of investors, such as angel investors or certain friends and family.

What Happens to Your Corporation after You Die?

A corporation remains in existence even if you die. It must continue to meet its obligations, including paying its employees and taxes and completing any ongoing contracts. Directors and officers are responsible for making sure the corporation continues these tasks. However, a director appointment is a personal right, meaning if you are a director of a corporation when you die, your Executor cannot simply step into your shoes and become a director of the corporation: they must be elected by the shareholder(s). This can be problematic if you are the sole shareholder and director and you die without a Will. The corporation's obligations may continue to build while your family and friends decide who will seek appointment as your Executor and exercise their rights to elect a new director on behalf of your estate. Moreover, this means that if you are the sole shareholder and director and die without a Will, you cannot control who will be elected as your replacement director(s). You will therefore lose a valuable opportunity to have input into management of the corporation's affairs after you die.

Do You Have a Shareholder Agreement?

When you are one of multiple shareholders in a corporation, your most important estate planning tool will actually be a shareholder agreement. This is an agreement between some or all of the shareholders governing various management and operational matters. Each of the *OBCA* and *CBCA* create a set of default rules that apply to all corporations incorporated under their respective jurisdictions, including the scope of directors' management duties and various shareholder rights and obligations. A shareholder agreement can modify or remove some of these default rules. For example, one of the most important questions is what might happen to the business when you die.

Sometimes, there is value to selling a business as a going concern by selling the corporation's shares. Other times, there is value to only selling the corporation's assets, or even simply winding up the corporation. In these latter cases, the shares are not sold – but can be used to distribute profits to the shareholders.

Other times, there is value to continuing to operate the business. The other shareholders may wish to buy your shares, or you might wish to have certain family members take over your shares and continue in the business.

All of the above options carry significant tax and valuation implications for your estate and consequently for your beneficiaries. A shareholder agreement can modify, grant or remove some or all of these options. While both the *OBCA* and *CBCA* provide remedies where a shareholder is being oppressed or treated unfairly as a result of actions taken by directors, these can be costly and time-consuming remedies to obtain and require resort to the court.

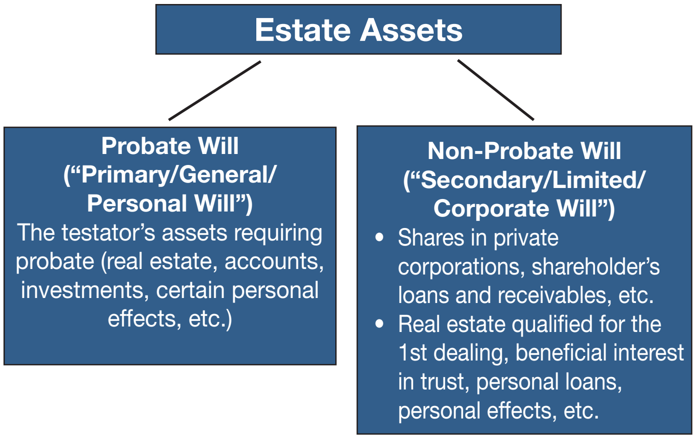
A shareholder agreement can govern how and when your estate is entitled to sell your shares, if that is the desired path. Without a shareholder agreement, there may be no practical way for the estate of the deceased shareholder to convert the shares into cash, possibly causing liquidity issues for the estate and leaving beneficiaries and dependents with an asset of limited benefit or use. There are default rules under the *OBCA* (or *CBCA*) that govern the rights and obligations of selling shareholders; however, they can be difficult to implement or enforce. Similarly, if the deceased owns 50% of the voting shares of the corporation, or less, the estate of the deceased shareholder may have limited ability to directly influence when and how profits of the corporation are distributed.

How Many Wills Do You Have in Place?

When you die owning shares of a privately-held corporation, your shares will be valued and dealt with as part of your estate. Your Will is another important tool to direct your Executor as to how your business interests will be dealt with after your death. Further, if you are an owner of a privately-held corporation, you may want to consider having multiple Wills.

As discussed above, when you die with a Will, your Executor may be required to obtain a Certificate of Appointment of Estate Trustee with a Will (so-called, "probate") from the court in order to administer your estate. The necessity of probate depends on the nature and extent of your assets and it is mostly determined by a third party asset holder. For example, if you die with a real estate property registered in your sole name, the Land Registry Office, in most cases, requires your Executor to obtain probate to sell your property. Similarly, if you own investments personally, your financial institution may request probate in order to release the funds to your Executor. In contrast, if you own shares of a private corporation, probate is often not required for your Executor to deal with your shares.

When your Executor applies to the court for probate, probate fees (officially called "Estate Administration Tax")[1] have to be paid along with your probate application. In Ontario, you can have two or more Wills to save probate fees and facilitate the administration of your estate assets' disposal which do not require probate. As you see from the chart below, the multiple Wills strategy allows you to separate your assets into two baskets (Wills) – one for your assets subject to probate and the other for your assets not subject to probate.



For example, if you die with only one Will owning shares in your corporation valued at $2,000,000 at your death, $29,250 will have to be paid as probate fees. Thus, by having multiple Wills, your estate can save $29,250 which would otherwise be payable as probate fees on the value of your shares. A careful drafting of your Wills and a comprehensive review of your affairs by your lawyers and tax advisors are required for a seamless administration of your estate under multiple Wills.

Leaving a Clear Roadmap to Your Loved Ones

Establishing and running a business requires a substantial amount of time, research, careful decision-making and hard work. Creating a roadmap for your loved ones allows you to maximize the value of your business for your estate, and to assist your loves one with unwinding or managing your business after you die. An estate plan is critical to provide your loved ones with a starting point and to ensure your affairs are looked after upon your death.

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[1] Pursuant to the *Estate Administration Tax Act, 1998*, if you apply for probate after January 1, 2020, Estate Administration Tax is calculated as follows:
- For estates valued $50,000 or less, no Estate Administration Tax is payable.
- For estates valued over $50,000, the Estate Administration Tax is calculated as $15 for every $1,000 of the value of the estate.

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