

Investor Insight

Dekker Hewett Group | Independent. Trustworthy. Experienced.

Business Owners: Revisiting the Buy-Sell Agreement

For business owners who want to ensure a successful transition of their company, buy-sell agreements on death, whether stand-alone or as part of a shareholders' agreement, are an important consideration. Here are some things to think about when preparing or reviewing an agreement:

Funding the Buy-Sell — The effectiveness of the buy-sell provisions oftentimes depends on the ability of the surviving shareholder(s) or the company to fund the transaction. If funds are not readily available, the company may need to sell assets or obtain external financing, which may negatively impact operations.

If the company has accumulated cash to fund the buy-sell, this surplus may be viewed as a passive asset that results in the shares of the company not qualifying for the lifetime capital gains exemption, foregoing tax savings.

Tax Implications — Tax implications will depend on whether the buy-sell agreement requires the purchase of shares by a surviving shareholder or a share redemption/purchase for cancellation by the company. A share purchase may give rise to capital gains in the hands of the selling shareholder or his/her estate, while a share purchase by the corporation (known as a purchase for cancellation) may result in a deemed dividend.

In certain provinces, capital gains are generally subject to a lower rate of tax than dividend income. The difference between these two approaches can be further magnified if the capital gains exemption is available.

However, if life insurance is used to fund the purchase obligations under the agreement, all or a portion of the proceeds may be received as a tax-free dividend through use of the company's capital dividend account (CDA).

Hybrid buy-sell provisions that allow for a share purchase and/or redemption/purchase for cancellation can provide greater flexibility for tax planning purposes.

Capital Dividend Account — If corporate insurance exists, the buy-sell terms must specify that the company treats dividends paid to the deceased shareholder, to the extent of the insurance proceeds, as tax-free capital dividends. Otherwise, case law provides that surviving shareholders could make the dividends to the deceased's estate taxable and retain the CDA for their own future benefit.

As always, we recommend seeking professional advice when preparing or reviewing the buy-sell agreement as it relates to your particular situation.

Dekker Hewett Group
Canaccord Genuity Wealth Management
609 Granville St., Vancouver, BC, V7Y1H2
T: 604.699.0852
E: dhginfo@canaccord.com
www.dekkerhewettgroup.com

CANACCORD GENUITY WEALTH MANAGEMENT IS A DIVISION OF CANACCORD GENUITY CORP., MEMBER-CANADIAN INVESTOR PROTECTION FUND AND THE INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

This newsletter is solely the work of the author for the private information of clients. Although the author is a registered Investment Advisor at Canaccord Genuity Corp., this is not an official publication of Canaccord Genuity Corp. and the author is not a Canaccord Genuity Corp. analyst. The views (including any recommendation) expressed in this newsletter are those of the author alone, and are not necessarily those of Canaccord Genuity Corp. The information contained in this newsletter is drawn from sources believed to be reliable, but the accuracy and completeness of the information is not guaranteed, nor in providing it do the author or Canaccord Genuity Corp. assume any liability. This information is given as of the date appearing on this newsletter, and neither the author nor Canaccord Genuity Corp. assume any obligation to update the information or advise on further developments relating to information provided herein. This newsletter is intended for distribution in those jurisdictions where both the author and Canaccord Genuity Corp. are registered to do business in securities. Any distribution or dissemination of this newsletter in any other jurisdiction is prohibited. The holdings of the author, Canaccord Genuity Corp., its affiliated companies and holdings of their respective directors, officers and employees and companies with which they are associated may, from time to time, include the securities mentioned in this newsletter.

The preceding information is for general information only and does not constitute tax advice. All investors should consult with a qualified tax accountant.
Tax & Estate advice offered through Canaccord Genuity Wealth & Estate Planning Services.

FOR DISTRIBUTION IN CANADA ONLY