Wills for the Owner-Manager – Some Special Considerations

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The will can play an important role in succession planning, not just as the instrument that details the succession of property between generations, but also as a complement to a shareholders' agreement that may be in place to set out the guidelines and rules by which the corporation should be governed. Accordingly, a will in the context of succession planning should not be overlooked as an additional tool to the management of a corporation after the death of the owner-manager.

Special issues that should be addressed in the will of an owner manager include the following:

- Does the testator hold thin-voting shares, e.g., shares which carry the right to control the family business; if so, should specific provisions be made in respect to these shares? (Some factors to be considered are discussed in Chapter 2.)
  Will the choice of executor result in association or other tax issues? (See Chapter 8 for further discussion.)

  Are there shareholders' or other agreements in which testamentary designations or elections are to be made? (For example, the shareholders' agreement could provide that certain roles, such as president or directors of a corporation, are to be filled by designation in the owner-manager's will. Additionally, a shareholders' agreement could allow for certain provisions relating to liquidity or profit distribution to be dependent on certain clauses as contained in the will.)

  Is the testator bound by a shareholders' agreement which restricts the manner in which a will can be drafted? As discussed in Chapter 11, a shareholders' agreement could prohibit an outright bequest of shares of the family business to a surviving spouse, restrict the permissible executors/trustees, and may, in the case of a spouse trust, preclude a power to encroach on capital in favour of the surviving spouse in the form of a distribution of shares from the family business.

  Care must be taken that the provisions of the will do not result in associated corporation issues. As discussed in Chapter 8, where beneficiaries' share of income or capital is subject to *any* discretionary power, each such beneficiary is deemed to own all of the shares held by the trust. Accordingly, care should be taken in respect of discretionary powers. As also mentioned, special rules may apply in the case of a testamentary spouse trust whereby the surviving spouse may be deemed to own the shares in the trust.

- Because of the potential incidence of double-taxation in respect to bequests of shares of a private corporation are involved, the ability to effect *post-mortem* reorganizations will be important. Needless to say, the will must provide the executors with the power and authority to cause the estate to effect such reorganizations, which may involve share redemptions/reacquisitions, transfers to holding companies, dissolutions, etc., including elections and designations.

  As explained in Chapter 12, where a will uses a spouse trust, it is prudent to provide for a lagged distribution on the death of the surviving spouse rather than calling for an immediate distribution to residual beneficiaries. One of these strategies involves a *post-mortem* redemption, which tends to trigger deemed dividends and capital losses; the latter can be

applied against the capital gain in the spouse trust occasioned by the surviving spouse passing away. Therefore, the spouse trust should be able to continue to hold assets within the normal three-year carry back period.[1]

- If a previous will has made a specific bequest, has the property been subject to a reorganization, so that it is no longer owned directly by the testator?
- Should multiple testamentary trusts be considered?
- Is there indebtedness that should be forgiven in the will? (See Chapter 8 for advantages.)

In addition to the foregoing, a typical "scenario" of a successful business will suggest other issues:

Letters of Wishes. If succession and estate planning have been attended to by the testator, and the family business has been successful, the will may account for only a minority of family assets and, in particular, the value of the family business. If an estate freeze has been carried out, it will typically be the case that much or most of the value of the business is either sequestered in a family trust (typically discretionary) in the form of growth shares, or the shares held by the trust were distributed to beneficiaries prior to its 21st anniversary. If such a distribution has not been made, it will be important that, in addition to the will, the testator provides guidance to the trustees of a discretionary family trust, in the form of a letter of wishes. Otherwise, particularly in view of fiduciary obligations, the trustees may distribute the shares and other trust assets "symmetrically". Letters of wishes are discussed further in Chapter 8.

Freeze shares/credit balances. If there has been a freeze of a successful business, the assets of the testator may often consist primarily of the freeze shares themselves, the family home, a vacation property and RRSPs or other deferred income plans. In addition, there may be liquid assets and "credit balances" of the frozen corporation(s) (i.e., amounts owing to shareholders), especially if the incorporated business has followed the practice of bonusing down to the small business limit, with excess cash (not needed for personal and living expenses) either retained or lent back to the corporation. (If the corporation's income has been within the small business limit, such credit balances may not exist and liquid assets could be locked into the corporation because of the high-tax cost of distributing funds not required for personal use**[2]**.) Thus, freeze shares and/or credit balances may be at least partly liquid in the sense that they can tap into corporate assets as a "call" on funds and other liquid assets built up in the corporate system over the years.

But while both freeze shares and credit balances will be liquid in this sense, credit balances will be "tax-paid" and can be left to the next generation without triggering a deferred tax liability. The freeze shares, on the other hand, will typically have a low cost base but significant value; accordingly, it will be very important to postpone the recognition of deferred tax on the freeze shares, especially if there are insufficient insurance proceeds or other liquid assets to defray the tax exposure. This will typically involve the use of a spouse trust; one reason is that, while also achieving the deferral, an outright bequest will leave the surviving spouse with the power to bequeath the freeze shares as he or she sees fit, e.g., if the surviving spouse were to remarry (see Chapter 8 for further discussion).

If, on distribution from a family trust or otherwise, the ownership of growth shares has been "skewed" to certain family members – presumably because they will be involved in taking over the family business – the freezer will often want his or her estate to be used to equalize other family members. If freeze shares pass to beneficiaries, it should, of course, be remembered that, by their nature, they will be retractable – i.e., redeemable by the holder; accordingly, restrictions on retraction should be addressed, perhaps in a family shareholders' agreement, as discussed in Chapter 11. If the estate is to continue to hold the shares – i.e., in one or more testamentary trusts, the will itself might provide guidance to the trustees.

Business v. non-business assets. In some cases, a testator will wish to leave "business assets" to some family members and non-business assets to others. If so, the will drafter should become knowledgeable in the particulars of the testator's corporate structure, as the testator will probably have

corporate assets in mind, as well as personally-held assets. In addition, thought should be given to whether *post-mortem* reorganizations will be required to meet this objective and whether they can be achieved in a tax-effective manner. Also, the meaning of “non-business assets” should be explored and specified in the will, one example being real estate used in the family business.

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[1] Also, as pointed out in Chapter 12, special provisions might be inserted in a spouse trust in order to facilitate a paragraph 88(1)(d) “bump”, per the requirements of paragraph 88(1)(d.3).

[2] A similar lock-in effect may occur because of recent decreases in corporate tax rates and the eligible dividend regime – see Chapter 2 for further discussion.