PROTECTING THE FAMILY BUSINESS FROM MARITAL BREAKDOWN

Carolyn Seitz

While nobody likes to think about the consequences of a failed marriage before walking down the aisle, the risks faced by shareholders in family business owners can be high. After all, without the proper protection mechanisms in place, a divorcing spouse could be entitled to half their partner's shares in the family business or half the monetary value.

Through a combination of corporate and family law, family business owners can take legal steps that will keep the shares in the company and prevent any of the value leaving if a marriage in the family breaks down. The first step is to ensure appropriate provisions are included in the family business shareholders' agreement. The shareholders' agreement can contain provisions preventing a shareholder from selling shares outside the family. This clause could be important if one of the owners needs to generate funds to settle a divorce claim.

The second step is to have a prenuptial agreement. Some family businesses make having a pre-nuptial agreement which protects the value of the business shares from a claim by a divorcing spouse conditional to owning the shares in the first place.

Requiring shareholders to sign a pre-nuptial agreement with their future spouse can be a sensitive issue, but when handled appropriately, the marital contract can be executed fairly and without hurt feelings. Having the clause in place in the shareholders' agreement well ahead of a potential marriage in the family is helpful. This will avoid anyone marrying into the family feeling like this new rule has been put in place just for them. Nobody likes surprises, so having an established rule in place will also help the shareholder discuss the requirement with a potential spouse even before an engagement and wedding are planned.

Shareholders in a family business may not be formally married but are nonetheless in an "adult interdependent relationship". In Alberta, couples are considered to be in such a relationship if they have lived together for three years or have a child together and cohabit. This definition replaces what we used to call a "common-law" relationship. An adult interdependent partner does not have legislated claims to property but can make a claim against family assets, including the shares of a family business by way of what is called an action for unjust enrichment.Essentially, this is a claim by the spouse for compensation for contributions made to the accumulation of assets or value during the relationship and it can include a claim for the increase in value to shares of a family business. Similar to a pre-nuptial agreement, cohabiting partners can enter into a cohabitation agreement which would govern the distribution of their assets in the event they separate.

There are several important requirements to keep in mind to ensure a pre-nuptial or cohabitation agreement is valid and upheld. These include:

- Each party has independent legal representation
- Each party makes full and accurate disclosures
- The agreement is not signed under duress
- The agreement is signed well before the marriage date

To discuss this in more detail, contact one of our lawyers in our Family Solutions group.

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GIFTS TO CHARITIES WHEN WE DIE

Rhonda Johnson

Starting this year, Canada Revenue Agency (CRA) has sweetened the pot for Canadians thinking about leaving some of their estates to charity: Give to a charity through your will or name the charity as a beneficiary on your RRSP/RRIF, TFSA or life insurance, and your estate will get a tax credit that can be used to save up to 100% of your income taxes on 5 years' returns (the year before death, the year of death, and up to 3 to 5 years after death- it used to be a total of 2 years). That could result in some great tax savings; plus leave a legacy for your favourite cause; plus leave more for your other beneficiaries.

But there is a catch: the transfer of the property or cash to the charity MUST occur within 3 to 5 years of death, or the entire tax credit is lost. As of January 2016, it is 3 years but CRA may shortly extend it to 5 years from date of death. In other words, it is a limited time offer. Executors need to act quickly to administer the estate and get the property transferred to the charity. For many estates, this strict time limit won't cause a problem. But frequently there are issues that can cause delay, and that may be beyond the executor's control. For example, there might be delays in selling real estate or art, or there might be complicated family dynamics and estate litigation.

So what can you do to make sure more of your estate goes to the beneficiaries (and less goes to taxes)?

1. In your will, make sure you give your executor the power to transfer specific property (called 'gifts in kind') to the charity, rather than waiting for cash.

2. If you are naming a few charities, consider making the gift to an intermediary foundation (for example, a Community Foundation) who can then sell the assets and distribute the gifts to the charities as per your wishes.

3. Consider naming the charity as the beneficiary directly in your RRSP/ RRIF or life insurance. The funds will go quickly to the charity, outside of the estate, without probate; the estate will get the tax credit; and the funds will be protected from estate litigation risks. More and more Canadians are giving substantial amounts to their favourite causes through their estate plans. CRA wants to encourage that, and these new rules are a great opportunity to create win/win scenarios- your favourite charity receives a legacy, and there is more left over for your other beneficiaries. But only if the charity gets the property within 3 to 5 years of your death. So we all need to make sure our estate plans are up to date and that our executors are properly empowered to carry out our wishes. Contact us today to discuss in further detail.

THE ADVANTAGES OF A LIMITED PARTNERSHIPS STRUCTURE FOR NEW BUSINESSES

Jeff Fixsen

When you start a new business, one of the first decisions you need to make is how to structure your business. Many people automatically assume that incorporating is strategically best, if for no other reason than it allows the business owner(s) to limit liabilities to the corporation, and thus protect personal assets. It's a familiar concept and one that is easily understood at your local bank.

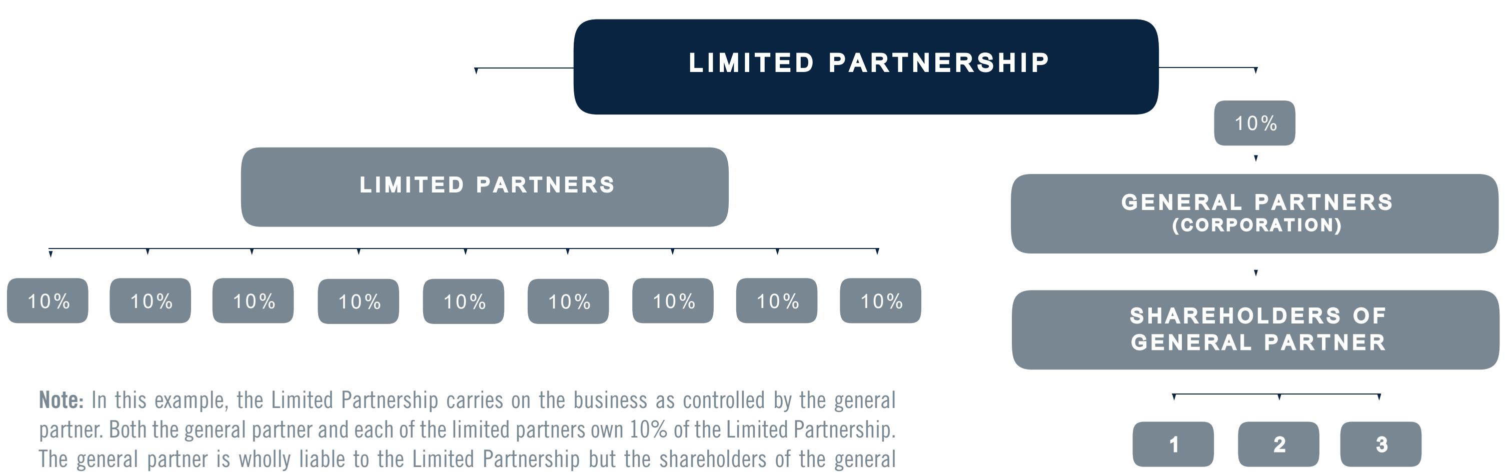
There is another option to consider, however: Limited Partnership. For some businesses, this structure preserves the benefits of incorporation while offering additional advantages. Here, we'll explore the details.

- A limited partnership allows you to **bring on investors without ceding control of your business.** The general partner(s) deal with day to day operations and do not need to consult the partners for most business decisions. That being said, you will need to hold annual meetings and create a detailed partnership agreement.
- As with a corporation, **a limited partnership can include limited liability** for both the general partner(s) and the limited partners. The limited partners' liability extends only to the amount that they contribute to the business, which can make it an attractive investment. The owners of the general partner may limit their liability by use of a corporation in a carefully drafted limited partnership agreement.
- A limited partnership also offers an **added tax benefit for all the partners.** Unlike a corporation where losses are typically 'trapped' in the company, in a limited partnership, all profits and losses flow through the business to the partners. This can be particularly interesting in the first few years of a business, or in a down economy, where losses are expected. Partners can choose to set these losses against other income, reducing their tax burden. It's important to note that if there is no reasonable expectation of profit, Canada Revenue Agency (CRA) may disallow the losses.
- Limited partners can come and go without dissolving the limited partnership, making this a **flexible structure**.

Limited partnerships can be used effectively in a wide range of industries including real estate development, mining and manufacturing. They can also be used to structure business agreements involving First Nations.

Although a limited partnership may be the right structure for your business at its outset, it is straightforward to convert it into a corporation at a later date. This may be a logical step to take once the business becomes more successful and starts to retain profits.

As with all advice, we recommend working with legal counsel and an accountant to ensure you take the best route for your business. These professionals can make you aware of compliance issues with respect to the Securities Act in your province, and with the regulations of the CRA.



Note: In this example, the Limited Partnership carries on the business as controlled by the general partner. Both the general partner and each of the limited partners own 10% of the Limited Partnership. The general partner is wholly liable to the Limited Partnership but the shareholders of the general partner have limited their liability by using a corporation as the general partner.

SHAREHOLDERS' AGREEMENT: RESOLVING SHAREHOLDER CONFLICT BEFORE IT STARTS

Edward Feehan

It is an unavoidable cost of conducting business that your corporation will inevitably be embroiled in a litigation dispute. What most owners do not realize, however, is that the disputes that cause the greatest level of damages to their business are the internal fights between the shareholders. The commercial litigators at Duncan Craig LLP are often called upon to resolve disputes between shareholders. How efficiently we can help resolve the conflict is often dependent on the dispute resolution mechanisms contained within a shareholders' agreement, if such a document even exists.

The types of disputes that can arise between shareholders are varied and their impact on the business can range from minor irritation to potential demise. Common disputes between shareholders include:

- Conflict over the direction of the company
- Underperformance or low involvement by one of the shareholders / directors
- Disagreement over compensation for directors / shareholders
- Conflicts of interest between competing investments
- The taking on of debt or ability to pay off debt
- The value of shares if one owner is looking to sell

A well-drafted shareholders' agreement can help prevent or minimize disputes by setting out the policies for managing many of these issues. It can also be used to specify the process for resolving disputes should they still occur. Having dispute resolution policies in place will help protect the on-going operations of the company by setting out the timeframe and process for resolving the conflict. For serious disputes, the shareholders' agreement can also be used to keep matters out of the Courts until the mutually agreed resolution mechanisms have been exhausted.

For more minor conflicts, most matters can be resolved at directors' meetings by majority vote or at a shareholders' meeting based on ownership of shares. In many cases, however, shares in the business are split 50/50 by two owners, which can create a corporate deadlock unless parties are willing to compromise.

If a dispute is more serious the shareholders agreement can require that it progress to mediation. A well trained, independent mediator can help manage the process and facilitate the negotiation discussions which can lead to a resolution agreement. The shareholders' agreement can also specify that disputes over financial matters can be referred to an independent financial expert. In both cases, the shareholders' agreement should also specify how the mediator or financial expert should be selected. Binding arbitration can also be used as a prescribed mechanism for dispute resolution in the shareholders' agreement.

If a conflict progresses to the point where the corporate shareholders no longer feel they can work together, the shareholders' agreement can specify how the sale of the business or individual shares should take place. A buy-sell provision, commonly referred to as a 'shot gun' clause, allows one shareholder to offer to purchase the shares of the other shareholder (or alternatively, sell their shares to the other shareholder) at the price of their choosing. The shareholder receiving the offer can either accept the offer and sell their shares or buy out their colleague on the exact same terms. Alternatively, the shareholders' agreement could require the sale of the business in its entirety.

Agreeing on the dispute mechanism clauses of a shareholders' agreement is a bit like signing a marriage pre-nuptial agreement. When relationships are strong and there is no conflict is the ideal time to ensure the shareholders' agreement contains the provisions needed to prevent and resolve disputes. Without the provisions in place, each owner will spend more time and money on a dispute that could have been prevented or minimized in the first place.

The bottom line is that an ounce of prevention in preparing a shareholders' agreement is worth a pound of cure in the courtroom.