

# Plan well when passing the torch



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**By  
Peter  
Merrick**

I've known franchisee Ike for several years, ever since his trusted public accountant, Ronald, introduced us. Ronald wanted me to implement some tax minimization and tax deferral solutions for Ike, focusing on executive compensation, pension and succession exiting strategies. Ike is a multi-unit franchisee with plenty of business sense, but everyone can benefit from some outside advice.

In 2004, I learned that Ike's tax strategies had helped him achieve yet another goal: transferring one of his franchised restaurants to his daughter, Patti.

I've read many studies about the desire of entrepreneurs to transfer their businesses to other family members, typically their children, when the time comes to retire. However, most of those businesses end up sold to third parties. This is usually because younger family members lack the money to buy their older relatives out, or simply have no interest in running the business.

For franchisees, there is a third hurdle. The relative must also be approved for ownership by the franchisor.

Ike, by seeking professional advice from his trusted advisors in every stage of the process, avoided these pitfalls and made possible another generation of franchise success.

Ike had always believed in a flexible business strategy that looks ahead five, even 10 years. Patti first expressed an interest in joining her family's franchised business as early as 1992. Ike's planning prepared him for the day when Patti was finally ready.

Part of being a mature business owner is considering your succession strategy with every business decision you make, in other words, taking the long view. In 1992, Ike told his accountant of his desire to sell his franchises to his children. As their family accountant, Ronald's role was to provide guidance and help Ike develop a business model and tax plan for this.

Ronald recommended that Ike reorganize his corporate structure to allow for an estate freeze on the future value of his business. An estate freeze limits the growth of capital property you hold during your lifetime; any growth in the capital property is transferred to your heirs.

Under this new arrangement, all Ike's franchisor required of him was that Ike own 100 per cent of the voting shares, and his children be recognized as non-voting shareholders. Ike shared ownership of the operating company with his children through a family trust. The children would be the trust's beneficiaries.

Remember, a trust is not a separate legal entity from the group or individuals who set it up. It is a device for holding property or

assets for the benefit of a specific person, group or organization, known as the beneficiary (in this case, Patti and her sister Ellen). The person creating a trust (Ike) is called the grantor, donor or settlor. When a trust is established, an individual or corporate entity is designated to oversee or manage the assets in the trust. This individual or entity it called a trustee (again, Ike).

Ike's new business structure allowed for his business' future profits and assets to accumulate in the family trust, with dividends to be paid through it to the children. This helped Patti and Ellen accumulate funds in the most tax advantageous way, because they were in a lower tax bracket than Ike, and because he could maintain control of the assets and split the income with his children.

The future trust also allowed Patti to meet the franchisor's fee by enabling her to accumulate her own funds.

Ronald the accountant also made two other recommendations that helped guarantee Ike's financial wellbeing. First, he recommended that Ike create an individual pension plan (IPP). Individual pension plans have become very popular with Canadian business owners because contributions to them can legally exceed the maximum allowable in a registered retirement savings plan (RRSP). Money placed in an IPP is deductible by the sponsoring company and is a non-taxable benefit for the individual. Increases in the total value of the assets held in an IPP are tax-deferred until withdrawn.

Ronald's second suggestion

was for Ike to purchase (through his new corporate structure) a corporate-owned universal life insurance policy. Universal life insurance allows for tax-sheltered growth within the policy. A corporate-owned life insurance contract can tax-shelter retained earnings in the cash value portion of the policy. One can access these funds for personal business use by collateralizing the policy. For example, as a retired business owner, you might borrow funds annually to increase retirement cash flow.

Any related bank or policy loans will be repaid automatically upon death from a portion of the policy proceeds. A credit to the corporate capital dividend account (CDA) would be simultaneously created, equal to the full policy proceeds.

Should Ike ever become disabled or critically ill, the corporate-owned UL insurance policy entitles him to the entire cash value without any requirement to repay the policy.

Thus, a corporate-owned UL policy can provide the following benefits for a franchise owner who chooses to adopt it:

- Corporate deposits can be deductible;
- All personal deposits can be deductible over time;
- Large annual deductions provided each year against income for the rest of your life;
- Tax-free retirement (even tax-free death), with savings protected from your creditors; and
- The corporation or personal deduction creates an annual cash-on-cash return of approximately 60 per cent, in a plan on which

taxes will never be paid.

With Ike's future secured, he turned his attention to the succession challenge itself.

To protect its brand, the franchisor holds the final say over who will be granted franchise rights. Most well-established franchising systems have created guidelines for franchisees and their successors:

1. All parties must be involved in all steps of the succession planning and transfer process.

2. The new family member must show an interest in and commitment to owning the business and have already worked it in a senior management position.

3. The franchisor will still hold final approval for any transfer of ownership.

In 2004, Patti met and far exceeded the panel's requirements. With the foresight of her father, the help of the franchisor's next generation training program and Ike's trusted financial advisors, Patti became a franchisee, just like her father before her.

The value of this long-term planning is not limited to this industry. Business owners of all stripes prepare for the day when their life's work will be passed along.

**Peter J. Merrick, BA, FMA, CFP, FCSI**, is the president of Merrick-Wealth.com, a fee-for-service financial planning and executive benefit consulting firm in Toronto. He is the author of "The Essential Individual Pension Plan Handbook" (Lexis-Nexis Canada, 2007). He can be contacted at: (416) 854-1776 or [peter@merrickwealth.com](mailto:peter@merrickwealth.com).