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Financial Matters

When a small business changes

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There are several key challenges to consider when you transfer ownership of a small business. The benefits can be considerable if you do it with care.

When a prospective buyer arrived at Reg Gilchrist's door years ago with an offer to purchase his company, he had little choice but to accept the proposal. Gilchrist, one of Canada's best-known distributors of coin-operated games, shuffleboard and pool tables and vending machines, had run his Toronto-based company for more than 40 years. His son, Tom, had left a promising sales career to join the company and would have bought the business himself, but at the age of 25, couldn't come up with a competitive offer. Nor could he pay the taxes on the company if ownership were transferred to him. So Reg Gilchrist sold his business, then helped his son start another one, called T. W. Gilchrist Vending Co.

Looking back on that period, Tom Gilchrist says it was a difficult decision for his father. If his own children decided to join the newer family business, Tom says, "I'd lay out the carpet for them."

About one million businesses currently operate in Canada with 100 or fewer employees. Like Gilchrist, their owners have to plan now for the time when they sell their company or pass it on to their family or beneficiary. In fact, a few hours of planning now could save a lot of time and money in the future and could even make the difference between selling the business or keeping it in the family.

With the help of a financial advisor, an owner can develop one of several possible plans that will minimize taxes and maximize the value of the company when it passes to the next generation:

Make full use of your lifetime \$500,000 capital-gain exemption, if available (this applies only to incorporated companies)

Consider an estate freeze, which allows you to retain control over the business while freezing the value of your interest in it so you can pass future growth on to the next generation

Purchase life insurance to address an anticipated tax liability in your estate or to keep the company afloat while your beneficiaries search for a buyer or reorganize the manage-

ment team

Determine the value

In planning to transfer a business, an owner first has to assess the value of the company. The value can be determined in several different ways, advises consultant, author and teacher Laurence Ginsberg

- **Adjusted balance-sheet or asset book value:** The price is equivalent to the present value of a company's tangible and intangible assets (goodwill, for example)
- **Asset replacement value:** "The value of the assets on a company's books may not reflect the real cost of their replacement," says Ginsberg. "You have to determine this cost to get a truer picture of the company's worth."
- **Discounted future cash flow:** This method is based on the current value of the company's future earnings. You determine the company's value and earnings over the next five to 10 years, then divide that figure by a number that reflects the risk that the business will not meet these expectations
- **Comparison:** Compare the business you want to sell with other businesses in the same industry that have recently been sold. "The drawback with this method," Ginsberg says, "is that you might think you're comparing apples to apples when you're really comparing apples to oranges." The other business might have 10 employees over the age of 50, for example, or its plant might have sprung a leak in the basement.

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Minimize taxes & maximize value



Did you know that we issue out-of-country travel insurance?

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Consider an estate freeze

If you decide to transfer ownership of the business to your children, you can reduce taxes during your lifetime and at death through the use of an estate freeze.

"An estate freeze allows business owners to crystallize their lifetime \$500,000 capital-gain exemption, if still available, and pass on the future growth of a business to their children," says John Natale, a member of the Tax and Regulatory Services Group at Manulife Investments in Waterloo, Ontario.

The parents essentially freeze the value of their shares, Natale says, by exchanging them for preferred shares, with a redemption/retraction value equal to their fair market value and issuing new common shares to their children. "Any additional growth in the value of the business will be reflected in the common shares, which are now held by the children," Natale says.

In addition to utilizing the \$500,000 capital-gain exemption and shifting the future growth in value of the company to your children, Natale continues, you can now quantify the taxes payable on death and allocate assets or purchase life insurance sufficient to pay the taxes owing.

Life insurance can be used not only to settle the tax liability at death but also to fund a shareholder buy-sell agreement or provide a cash infusion to keep the company viable while the owner's heirs try to sell it. As well, business owners could consider buying certain personal investment products, such as segregated funds and Guaranteed Interest Contracts (GICs), through a life insurance company in order to enjoy creditor protection on those investments.

Content courtesy of WealthStyles from Manulife Investments

Local Events**Apr 18—20**

Cherry Blossom Festival
Fujisawa Zen Gardens
www.zenculture.com

Apr 23-24

Windsor Technology Expo
Ciocaro
www.windsortechexpo.com

Apr 27

Sunoco Earth Day
Malden Park
www.erca.org

May 4

Path to A Better Heart -
5K Run/Walk
Malden Park
www.cardiacwellness.net

May 10—11

Shore & Songbird Celebration
Hillman Marsh
www.erca.org

May 25

RCMP Musical Ride
Windsor Stadium
www.windsorparade.org/main/

May 30

Advocis Poor Boy Luncheon
Downtown Armouries
www.ccfwindsor.ca

May 30

Lobsterfest
Ciocaro Club
www.roselandrotary.com

June 7—8

Art in the Park
Willistead Park
www.rotary1918.com

For more information on the above events, or to find out about more exciting events, visit:
www.citywindsor.ca

Strategies To Make The Best Use Of Your RRSP Refund

Since after-tax retirement income is the most significant long-term financial goal for most people, understanding and choosing the best refund strategy is critical. The following are five distinct RRSP Refund Strategies, each producing different levels of retirement income. To illustrate, let's assume you have \$1,000 to invest and are in the 50% marginal tax bracket.

1. Spend your refund.

Unfortunately, the most common RRSP Refund Strategy is to spend it. If your primary goal is to produce never ending retirement income, then you must realize that by spending your refund you significantly reduce the retirement benefit. The \$1,000 investment will generate a \$500 refund, reducing the after-tax cost to \$500. If you spend the refund, your after-tax commitment to your retirement goal is really only \$500.

2. Reinvest your refund.

To get more retirement benefits from your RRSP, you can reinvest all of the refund back into your RRSP (assuming you still have contribution room available). Simply investing the 50% tax refund increases your RRSP by the same 50%. By investing the \$500 refund, your \$1,000 RRSP investment increases to \$1,500. You can also reinvest your refund into a child's RESP.

3. Gross-up.

Consider borrowing additional funds to gross up your RRSP contributions* (assuming you still have contribution room available). As an example, for your \$1,000 RRSP contribution, you can borrow an additional \$1,000 to increase your contribution to \$2,000. Your \$1,000 tax refund is used to immediately repay the loan so you pay little, if any, interest. By 'grossing-up,' you get the maximum RRSP dollars working for each dollar you have to invest.

4. Top-up.

Traditional RRSP loans present the opportunity to top up RRSPs to make the maximum annual contribution possible. If your RRSP contribution room for the year is \$5,000 and you only have \$1,000, you can borrow the extra \$4,000 and use the refund to pay off most of the loan.

5. Catch-up.

'Catch-up' loans are larger RRSP loans used to catch up all unused RRSP contribution room at once. This is an extension of the 'top-up' strategy, but the loan is paid off over several years. If you had \$20,000 in unused RRSP contribution room available and got a \$20,000 catch-up loan, your tax refund would pay down \$10,000 of the loan, the remaining \$10,000 could be paid off over a few years.

Some of these strategies are complicated, and careful thought should be put into employing them. Consult with your advisor, who can work with you to decide which strategy will best help you meet your financial goals.

As of 2005 the 30% foreign property limit (foreign content rule) has been eliminated on RRSPs, RPPs and other tax deferred retirement plans thus allowing broader international diversification opportunities for retirement investments.



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