The Quarterly

williams & partners
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Passing Down the Family Business

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Family owned businesses are the cornerstone of the Canadian economy. According to various Canadian sources, family-owned businesses generate approximately 60% of Canada's gross domestic product and employ over six million Canadians. Additionally, family businesses create 70% of all new jobs and fund 55% of all charitable donations.

With an aging population, many entrepreneurs and current business owners are faced with the intricate decision regarding the future of their companies. For many, family businesses have been the bread and butter of their families for many generations and a symbol of the family name. For these reasons, many find it difficult to sell their businesses to third parties. When passing down the family business to a family member, there are a number of factors that need to be considered.

Have a well executed succession plan

The key to making the best decision about passing down the family business is a well executed succession plan. This type of planning should take place five or more years prior to passing on the reigns and will help the owner decide who the future owner should be and how to prepare for the transition. In this planning process, there are various factors that one must consider. Primarily, the owner must distinguish whether or not their successor actually wants the business. Parents are encouraged to let their children decide on their own career path, especially at a young age. A successor who is obligated to be in that position is set up for failure. Additionally, the owner must ensure that the successor has the necessary skills and credentials. At times, someone in the business other than the family member is better suited for the position and thus can mentor the successor and in some cases, co-ownership can be an option. Sufficient training and mentoring is the key to future success. Further factors to consider include future profitability, competitors and customer trends. It may not be the best solution to pass down a business that does not look promising in the future.

Minimize family disputes

The leading cause of failure in family businesses are disputes, resulting in poor decision making and management problems. Entrepreneurs are usually faced with the dilemma of who to pass the business on to and in some instances erroneously make the mistake of equally spreading ownership across all their children. Sibling co-owner arrangements usually result in irresolvable disputes and eventual failure. An even bigger mistake owner's make is giving one child business ownership and the other ownership of real estate where the required skill sets and interest in running the business are not matched.

In order to ensure equality in the household and avoid family quarrel, there are various solutions. A common solution is splitting the class of shares, giving those that are not actively involved in the business restricted shares. A further solution would be to give the benefits of a life insurance policy to those who do not inherit the business. In the case of co-ownership, an independent board of directors should be appointed to avoid disputes.

Once owners decide on giving the ownership to the successor, there may be a lack of trust. This results in the owner continuing to be active in decision making and does not give the successor authority to manage freely. If this will be the case and the lack of trust will not be remedied, the best solution is to either a) sell to a third party or b) give authority to the individual while engaging a third party to oversee their actions.

Consider the tax implications

So the decision is made, and the owner decides to pass on the business to one of his/her children. What must the owner now consider? Owners may make the mistake of giving the business to their children for a nominal value without considering the tax implications. In this situation, the Canada Revenue Agency could determine their own estimate of the fair market value of the business and use this figure as the deemed proceeds on the disposition of the shares. This would trigger unfavourable tax consequences. With proper tax advice and the execution of a well implemented estate freeze, the owner may be able to utilize the capital gains exemption with respect to the transfer. In addition, the owner may maintain some control of the business through preferred shares and continue to have a stable stream of income upon retiring.

Scientific Research and Experimental Development ("SR&ED") Tax Credits – An Update

The 2012 Federal Budget announced several changes to the SR&ED program which were anticipated following an expert panel review of the SR&ED program. These changes propose to make the program more cost effective and predictable while providing a more simplified and focused approach.

In short, the federal and provincial governments are committed to the SR&ED program and continue to provide generous tax incentives to companies that undertake qualifying research and development ("R&D") activities in Canada.

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What are the criteria?
Under the SR&ED program, the Canada Revenue Agency ("CRA") requires a research and development "project" to entail some degree of technological advancement in a field of science or technology embodying some level of technological uncertainty. In addition, technological content must be present. Technological advancement is taxpayer specific (i.e. as long as it is an advancement for the company). The advancement need only be slight and the technological hurdle does not need to be insurmountable.

How does the program operate?
The SR&ED program provides support through enhanced deductions and tax credits. Eligible expenditures, both current and capital are currently fully deductible. As proposed in the 2012 Federal Budget, capital expenditures made after 2013, however, will not be deductible.

In addition, investment tax credits ("ITC") are earned on expenditures such as wages, materials, equipment and a portion of overheads. The federal ITC rate for small Canadian Controlled Private Corporations ("CCPC") is 35% of current and capital (prior to 2014) expenditures on qualifying R&D. The federal ITC rate for large CCPC's is currently 20% but will be reduced to 15% after 2013 as announced in the 2012 Federal Budget.

In computing SR&ED expenditures, a taxpayer can elect to use a "proxy method" to calculate qualifying overhead expenses. The prescribed proxy amount is currently 65% of the portion of salaries and wages of employees directly engaged in SR&ED activities carried on in Canada. The 2012 Federal Budget proposes to reduce the rate to 60% in 2013 and 55% thereafter.

Contract payments to arm's length performer of SR&ED are also eligible for deduction and credit. The 2012 Federal Budget proposes to limit the amount for ITC to 80% of the contract payment after 2012.

Many provincial governments including Ontario also provide incentives for R&D. The Ontario Innovation Tax Credit and Reseach Development Tax Credit provide an additional 10% and 4.5% tax credit, respectively.

How much will companies save?
The combined federal and provincial deductions and incentives can reduce your costs to less than $41 for every $100 spent on R&D activities. This funding can facilitate further product development, technological advancement and cost reduction.

Tips for tracking SR&ED information
In order to take full advantage of the SR&ED program, SR&ED information should be properly logged and tracked. Here are some tips on tracking SR&ED information:

1. Designate an SR&ED supervisor – An individual experienced in the company's operations should be assigned the task of analyzing potential SR&ED submissions, acting as a liaison with SR&ED consultants, and monitoring each project from start to completion. This person can be an invaluable part of the SR&ED process and help to improve the efficiency and effectiveness of the claim submission.
2. Create a project planning document – When a project is conceptualized, this should be written down and the details of the technological advancement or uncertainty should be described. This initial project planning document should be reviewed throughout the project as the initial uncertainty may be eroded over time.
3. Have time sheets – Employees should log their time and differentiate between time spent on SR&ED eligible work and time spent on routine engineering. If the time tracking software is geared towards particular business projects rather than SR&ED projects or activities, the employee should annotate in their time description (SR&ED → Project # → Project name → # of hours of SR&ED work performed).
4. Setup an SR&ED email account – create an SR&ED e-mail, i.e. , companySR&ED@domain.com. All e-mails between colleagues, consultants, and or contractors should have the SR&ED email carbon copied. This will help to create a single repository of all SR&ED correspondence.
5. Start early – The sooner the above tips are implemented, the more efficient the claim process becomes. In most cases when SR&ED time is properly tracked, corporations spend more time and resources on the SR&ED process than they originally thought.

We can help
The SR&ED rules can be quite complex and we can assist you in determining eligible projects, preparing project descriptions, determining qualifying expenditures and prepare all relevant forms for submission.

Mandatory Workplace Safety & Insurance Board ("WSIB") Clearance Certificates

The Ontario government has introduced Bill 119, making it mandatory for independent operators, sole proprietors, partners in partnerships and executive officers to pay WSIB premiums on their own earnings beginning January 1, 2013. The intention of the Ontario government is to improve safety in the industry and eliminate what some would call an "underground economy". However, many have criticized the Ontario government's approach, claiming that it will be detrimental for small to medium sized companies, resulting in future problems in an already fragile construction industry.

Exemptions to the new rules
Home renovators who employ no workers, work exclusively in home renovations directly for the homeowner and are paid directly by the homeowner are exempt from this new rule.

There are also some exemptions, with restrictions, for corporations and partnerships. These businesses may select one executive officer or partner to apply for an exemption. In order to qualify for this exemption, the individual must not perform any construction work, though periodic site visits are permitted under the legislation. Also, only one person per company can be exempt.

Registration and clearance certificates
An independent operator, meaning an individual who does not employ workers, reports as self employed to a government agency and has been a contractor or subcontractor for more than one person during an eighteen month period must have a clearance certificate prior to entering a job site. Under the current legislation, a failure to provide the principal with clearance will result in refusal to enter the jobsite and potential lost contracts.

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In order to be eligible for clearance certificates, contractors/subcontractors must have WSIB coverage and pay their premiums on time.

Consequences of non-compliance

A failure to comply with the new regulations has various consequences as it will be an offence under the Workplace Safety Insurance Act. If hiring a contractor without a clearance certificate, the principal will be liable for any unpaid premiums. In addition, individuals can be fined up to $25,000 (up to $100,000 for corporations) and possible imprisonment.

Hiring the Right "Fit"

Ensuring the right person is hired to meet the requirements of the job is not the only thing that employers should be looking for in candidates. Each company has its own culture and environment, vision, mission, values and client focus. The importance of hiring the best suited candidate should ultimately include a candidate that meets all aspects of the job, not only the technical needs. When it comes to developing staff, employers have to realize that it is very difficult to train "fit", and it may be more feasible to train someone on technical aspects if they have the basic knowledge.

To ensure the candidate fits your organization, consider the following:

- Does the candidate exhibit the ability to collaborate with the existing team to meet company objectives?
- What are the company's vision and mission and has the candidate demonstrated their alignment with such?
- Would there be any apprehensions in introducing this candidate to clients as part of the team?
- Will the candidate consider feedback to make improvements and efficiencies?

As a best practice when considering candidates through the interview process, consider asking behavioural questions. These types of questions focus on specific examples that the candidate will share that should indicate how their future behaviour would be if they were faced with the same situation. Some examples of how behavioural questions may commence are:

1. Tell me about a time when...
2. Give me an example of how you...

It's also very important to be thorough during the overall recruitment process to ensure all aspects have been considered for the candidate selection. Try to understand the environment of the job and get to know the team that the person will be working with to ensure the right fit is selected. One way to achieve a better understanding is to complete job shadowing of the position. Not only will this allow the employer to better understand the actual technical skills and abilities needed to perform the job; it will also provide them with an opportunity to interact with other individuals and observe issues related to the role. Completing thorough reference checks after the interview with the preferred candidate will allow the employer to get different perspectives on how the candidate has worked in different environments as well and provide some more objectivity in the selection process.

Fit goes both ways. Remember that the candidate is also assessing the employer through the interview process to determine if this is the right environment they wish to be part of. When candidates ask questions, it truly demonstrates their interest in the company and outlines the thought they have given to being part of the team.

Good luck with hiring the right "fit".

Tax Tip: "Principal Residence Exemption & Excess Land"

A gain on selling your home is normally completely exempt from taxation. The term "principal residence" includes, among other things, a house, a condominium, and a share in a cooperative housing corporation. It also includes the land around the house, but normally only up to one-half hectare (about 1.2 acres). If the land is in excess of one-half hectare then the excess is not included as your principal residence (and therefore not eligible for the exemption) unless you can establish that it is "necessary for your use and enjoyment".

In a recent Federal Court of Appeal case, a taxpayer sold a home that he had owned for several years for a significant gain. The land surrounding the home was approximately 2.5 hectares and up until the year of the sale could not be legally subdivided. The property was approved for subdivision by the municipality in the year of sale. The taxpayer argued that until the time of sale, the entire property including the 2.5 hectares was necessary for his use and enjoyment and therefore part of his principal residence in each year he owned the property.

The Canada Revenue Agency ("CRA") disallowed the principal residence exemption with respect to the portion of the gain relating to the land in excess of one-half hectare and was of the view that the one-half hectare test applied at the date of sale only.

The Tax Court of Canada agreed with the CRA. However, following an appeal to the Federal Court of Appeal, the court sensibly agreed with the taxpayer and was of the view that the principal residence determination should be made each year, not just at the time of sale. Accordingly, the taxpayer's entire capital gain was exempt.

There is technically a requirement to file a form with your tax return in the year of sale to claim the principal residence exemption. Fortunately, the CRA takes the administrative position that the form does not need to be filed except where the principal residence exemption does not completely eliminate the gain on the sale of the property. This might be particularly important in a situation where there is some sensitivity or doubt as to whether the principal residence exemption is available in whole or in part to the taxpayer (i.e. the sale of property in excess of one-half hectare). In addition, where multiple properties have been sold in the year, filing of a principal residence exemption is advisable.

TAX TIP deals with a wide variety of issues and the information is general in nature. As each person's circumstances are unique, readers are urged to consult W&P prior to acting on the basis of material in this Tax Tip. If you have any questions regarding the content of this or any other Tax Tips, please contact the W&P Tax Group.

Client Corner - Insureit Group Inc.

Located in Markham, the professionals at INSUREIT GROUP INC ("INSUREIT") have been looking after the insurance needs of Ontario families and businesses for over 40 years. Throughout its 40 year history, INSUREIT has stood by its motto of "Getting it right takes expertise, time, and diligence. Getting it wrong can be costly! Your peace of mind..We Insureit".

Under the leadership of owner David V. Palermo and General Manager Mike Naples, the team of thirty-two employees have been offering a variety of home, auto, business, life and leisure insurance products to a diversified client base. The goal of the team at INSUREIT is to provide their clients with a one stop solution of insurance products and end-to-end customer service.

INSUREIT specializes in full-account services, delivering cost effective, dependable insurance planning and risk management services in several sectors including: manufacturing and processing; wholesale and distribution; contractors and security; real estate; transportation; information and technology; automobile and garage; office, services, and professions; and retail.

INSUREIT also offers a specialty line of insurance products for directors and officers, bonding, errors and omissions, boiler and machinery/ equipment breakdown.

News Bits

Carlo De Pellegrin
On April 26, 2012, St. Michael's College School inducted Carlo De Pellegrin into the Order of St. Michael. The Order of St. Michael is the highest honour that St. Michael's College School can bestow on a member of its community. It is awarded to individuals who embody the Basilian Fathers' motto, "Teach Me Goodness, Discipline and Knowledge" through their contribution to the spiritual, academic or material welfare of the school and the greater community. The members of the Order serve as models for both students and for all of society. Carlo graduated from St. Michael's in 1966 and has consistently volunteered at the school, serving on various committees including the Building Fund Campaign Committee, Golf Tournament Committee and Building on Strong Foundations Committee.

New team members - We are also pleased to announce the following new additions to our team:

Jim Kernohan
Jim Kernohan has joined our tax group as a Principal. Jim has over fifteen years of experience working in medium-sized public accounting firm's working with owner-managed businesses handling tax and estate planning opportunities. Jim's background and experience will be an asset and welcomed addition to our team.

Sabbir Huq
Sabbir has joined the firm's accounting group as an analyst. Sabbir graduated from the University of Waterloo with a Bachelor of Honours Accounting & Financial Management. Sabbir has successfully completed the UFE examination. The UFE is a three day exam administered by the Canadian Institute of Chartered Accountants and is the final academic requirement to being admitted into the Institute.

Michael Covello
Michael has joined the firm's accounting group as an analyst. Michael graduated from the Richard Ivey School of Business at the University of Western Ontario with a Bachelor of Honours Business Administration and is preparing for the first examination in the CA process.

Michelle Ho
Michelle has joined the firm's accounting group as a bookkeeper. Michelle graduated from York University with a Bachelor of Administrative Studies (with Honours in Accounting). She is a certified Payroll Compliance Practitioner and has completed the Certified General Accountant level four exam.

Welcome Jim, Sabbir, Michael, & Michelle!

Summer 2012 Planner		
	August 6th	Civic Holiday
	September 3rd	Labour Day
	September 17th	3rd income tax instalment payment for 2012 due

CONTACT US
You can reach us by phone at **416.969.8166** or on-line at **www.williamsandpartners.com.**

NOTICE
Williams & Partners distributes tax tips on a regular basis via email to our clients. If you wish to be on our email distribution list for tax tips, please contact Jackie Pincente at 416-969-8166 ext. 235, or by email to jackie.pincente@williamsandpartners.com.