BMO Wealth Insights

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Key considerations for **business owners**

BMO ®

Introduction

As an owner of a private business you face the difficult challenge of balancing the needs of your business with the needs of yourself and your family. Your business demands a significant amount of your time and finances in order to generate earnings and growth that will ultimately be used to achieve your personal financial goals.

This two-part series focuses on considerations that relate with the life cycle of a business and its owner. There are four major stages of the business life cycle: start up, growth, maturity and exit. The first issue focuses primarily on key considerations that can help you to achieve your personal and business goals. The second issue will explore considerations specifically relating to the business itself, to ensure it is able to adapt to change and can continue building toward sustainable success.

In this first issue, we explore topics unique to the personal side of the business owner, from the value of a wealth plan to the best structure for your business. Following that, we focus on the strategies and solutions that are appropriate to reduce the risk to the business owner in achieving business goals and funding long-term retirement goals. We then explore questions about business succession – when is the right time to sell, and who could potentially take over your business? Finally, as you approach the exit phase of your business, you may begin to contemplate what's next for you, and the legacy you will leave behind with your business. We'll explore how establishing a donor advised fund or a private foundation can help build that lasting legacy.

As a business owner, life can get complex when personal wealth management and managing your business are closely intertwined. Through our services, we can help reduce the complexity, allowing you to focus on growing your business. We can also provide guidance on business transition and succession planning when you are ready to move on to the next chapter in your life.

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The value of a wealth plan for a business owner

Business owners need to integrate their personal goals with the needs of their business as they journey through the various stages of their personal and business life cycles. With so much time and effort invested in the business, there is often little time left to address personal and family issues. A well-thought-out wealth plan will help to identify a business owner's personal and business needs and priorities.

A business owner is the driving force of their business. They are always thinking about their business, innovating and making changes so that both they and their business can succeed.

Starting and operating a business is not for everyone. Being your own boss requires a huge commitment, and a significant and ongoing investment of both time and effort. Lasting success also requires business-specific knowledge, real passion and the ability to take smart, calculated risks in order to get ahead – and stay ahead – financially.

Personal goals versus business goals

Owners of a private business constantly face the difficult challenge of balancing the needs of their business with the needs of their family. There are trade-offs in time and financial commitments that business owners must constantly make as they strive to generate the reliable business earnings and growth that will help them achieve their own financial goals.

With so much focus dedicated to the business, there is a tendency to overlook these goals and to delay decision-making regarding important aspects of a wealth plan:

- Financial planning
- Tax planning
- Estate and Trust issues
- Philanthropy
- Business transition and succession

A wealth plan can address all of these areas to meet a business owner's personal and business needs. It allows a business owner to make the most of their assets; it helps protect their assets; and it develops a plan for their wealth to end up in the right hands. An effective wealth plan employs tax-efficient strategies in every area of their financial dealings, plans for a comfortable retirement, and factors in the unexpected and takes care of loved ones – now and in the future.

The wealth plan

A holistic wealth plan focuses on the big picture by implementing customized strategies to achieve three primary wealth goals: accumulation, preservation and distribution. The implementation of a wealth plan and the achievement of primary wealth goals are enabled. By engaging a financial planning process that includes several steps: clarifying goals, identifying hurdles and exploring options, evaluating the recommendations presented in the plan, deciding on solutions and strategies that best meet needs and goals, implementing the plan, and reviewing it on a regular basis.

Wealth planning for a business owner should include personal financial planning alongside planning for the business. Business and personal financial plans have very different focuses, but for the business owner it is very important that the two plans work together. At its most basic, a business plan documents the steps that the business will take to earn profits and grow, and to preserve the growth and sustainability of the business. These profits and the eventual value of the business may be withdrawn and used to achieve personal and family goals, implemented in a personal financial plan. These goals may include plans for cash management, tax planning, investment planning, insurance planning, retirement and succession planning, and estate planning.

Key areas of focus in the personal financial plan of a business owner

Cash management

Businesses in the start-up phase tend to have high capital investment needs relative to the amount of revenue that the business is able to generate. Access to investment capital and the reinvestment of earnings in the business may compete with the need for cash flow to support personal and family needs. The income of the business should finance day-to-day business operations, but it will also be needed to fund the lifestyle, daily living expenses and savings for other goals of the business owner and their family, as well as managing debt.

Even though it may be possible to withdraw regular profits to support personal needs, a business can represent a large illiquid asset for the business owner. Strong financial management is essential to ensure long-term business stability and, ultimately, the growth of personal wealth over a lifetime. Both the business and the business owner can benefit from a prudent and efficient cash management approach.

Tax planning

Minimizing taxes is a major factor contributing to an efficient cash management approach. Business owners benefit most when personal and business taxes are considered in combination. Leaving funds in in a C corporation business can help to minimize taxes if the corporate tax rate is less than the individual tax rate. However, this strategy may result in double taxation if

dividend withdrawals are contemplated and also limits the growth of personal investment assets, but it may have advantages for the business.

It's important to consider the right business structure for the business to maximize tax efficiencies but also to protect the business owner and the assets they have accumulated within and outside of the business.

There are many tax-saving strategies that may be implemented with guidance and advice from a tax professional: electing to deduct the cost of eligible capital additions, fringe benefit plans including plans for health, charitable donations, estate freezes, home office deduction, maximization of retirement savings with a MyRA, Simplified Employee Pension Plan (SEP-IRA), Savings Incentive Match Plan for Employees (SIMPLE IRA), 401(k), and defined-benefit plan.

Insurance planning

Determining the best method to protect the business owner, their family and the business requires specialized knowledge of risk and of insurance-based strategies. In some circumstances it may be advantageous for insurance to be held by the business rather than personally.

Health-related risks that can be mitigated through the use of insurance include the risk of the business owner becoming disabled, suffering a critical illness or dying. Insurance can provide the funding necessary to protect the business owner's family in the event of an unforeseen illness, disability or accident. Policies that help meet the needs of the business are available, such as a policy that will continue to pay business overhead costs while the business owner is unable to work.

Being your own boss requires a **huge commitment of time and effort**

Income-splitting strategies can be effective in reducing a business owner's overall tax bill. For example, assets or income can be allocated to other family members in lower tax brackets. Limited Liability Companies (LLC) electing to be taxed as an S corporation or other tax-efficient ownership structures should be set up in consultation with tax and legal advisors.

Investment planning

A successful investment strategy begins with asset allocation. However, for a business owner, diversification from the business is a key consideration. As most of an owner's financial assets are tied up in the business, the achievement of other financial goals is dependent on saving and investing outside of the business in accounts such as 529 Plans, High Cash Value Life Insurance. Or in an annuity.

If surplus funds are left in the business or corporation, it is also possible to invest these amounts. Care should be taken regarding the liquidity and safety of any investments of this type, especially if short or medium-term cash needs are forecasted for the business.

Life insurance should also be part of a business owner's estate plan, as it could be used to repay any outstanding corporate debt. Among many other possible uses, insurance could fund buy-sell arrangements with other shareholders, settle income tax liabilities arising upon death, or create an inheritance for children who are not taking over the business.

Retirement and Succession planning

Business owners often concentrate on their business and do not fund their retirement on a regular basis. There are a number of tax-advantaged savings options that can help a business owner save for retirement or for when they exit their business. These plans include MyRAs, Simplified Employee Pension Plans (SEP-IRAs), Savings Incentive Match Plans for Employees (SIMPLE IRAs), 401(k)s, and defined-benefit plans.

Will the business owner sell the business, or establish a deferred compensation plan to fund their retirement? A succession plan prepares the owner, the owner's family and the company's employees for the day when the business owner no longer participates in the business.

Professionals active in business transition and succession suggest that planning should begin as early as 10 years before the planned exit in order for the succession to be most beneficial. This will allow time for the owner's children or senior management to grow into their new roles and establish their authority. If the business succession involves selling the business to non-family members, life insurance can be used to protect the seller by insuring the life of the purchaser; if the purchaser dies prematurely, any outstanding loans could be repaid without depending on company resources.

Estate planning

A business owner should make sure their estate and legacy goals are documented and include plans for business assets – with at minimum an updated Will and Living Revocable Trust. A valid Will and Living Revocable Trust for business assets to minimize future probate costs and secure a smooth business transition is beneficial. At the time that the business owner's Wills and Trusts are being updated, powers of attorney should also be refreshed, providing authority for trusted individuals to take care of the business should the owner be incapacitated.

A business owner's Will and Trust should include instructions for the handling of their interest in the business after their death. Whether it should be reorganized, wound up, sold or maintained as an ongoing concern, it is wise to have appropriate provisions in the Will and Trust. It's important to ensure that the instructions in the Will and Trust do not contradict existing contracts such as shareholders' agreements, loan agreements and other promissory notes.

Conclusion

Having a wealth plan in place helps give business owners added confidence about their progress toward achieving their personal and business goals.

Wealth planning for a business owner poses unique problems, based on the combination of the owner's personal and business situations. It is important for business owners to separate their personal financial goals from those of the business, and work to accomplish these priorities as they progress through successive phases of their family and business life cycles with a personal financial plan.

We believe that professional advice and planning go hand in hand. By working with BMO financial professionals who understand the importance of addressing the personal needs of business owners, a business owner can get advice that is tailored to their individual and business needs, and can plan for a financially stronger future.

Working with your BMO financial professional

BMO provides a range of banking services focused on providing financial advice to a variety of clients, including businesses and business owners.

As entrepreneurs venture into a new business, they are often faced with many difficulties. This may include managing the day-to-day operations and finances, seeking additional opportunities for growth, staying on top of financial responsibilities, and ensuring sufficient funds for unexpected expenses, amongst many others. With their hectic schedules, entrepreneurs may benefit from working with a financial professional. Financial professionals can alleviate many of these difficulties by providing expert advice on financial tools, better management of finances, and additional connections to other professionals who can help.

There are many services that BMO can offer to business owners. As well as providing short and long-term loans, mortgages, leasing and other financial products, BMO can offer business-related services such as payroll deduction, term deposit receipts, cash management, insurance, electronic fund transfer and credit cards. Business banking also includes more general services, such as introducing clients to one another, identifying economic trends and forecasts, providing information relating to specific industries and explaining financial regulations and requirements. A financial professional can act as a main pillar of support and advice for an entrepreneur, smoothing the transition into a new venture.

A strong relationship between a business owner and their financial professional can play a big part in the financial success of a company. When looking to establish a new relationship with a financial professional, consider their previous experience with your industry and how well their educational materials resonate with you. Being able to establish and maintain a good relationship will help your business in the long run.

When you have selected the financial professional that you want to work with, the focus shifts to maintaining that relationship. The keys to this relationship are building trust and keeping an open line of communication. There are a few things that make this easier:

Having a business plan

Making frequent progress reports to your financial professional

Scheduling meetings regularly

Keeping track of loan repayment deadlines

For a business owner, a financial professional can be the difference between good or poor financial health for the company. Please reach out to your BMO financial professional to see how they can help your business grow.

Choosing the right **business structure**

Of all the decisions to be made when starting a business, one of the most important is the type of legal structure the business owner selects for their company. This decision impacts both the owner and the business in many ways: tax liabilities, the amount of aministrative complexities, the management of debt, and the extent of personal legal liability for the owner.

Choosing the business structure is one of the first steps in starting up a business. The structure that makes the most sense will depend on individual circumstances. Each business structure has advantages and disadvantages that will be integral to the personal and business success of the business owner.

The business structure influences everything from day-to-day operations, to taxes, to the amount of personal assets at risk. The business owner should choose a structure that gives the right balance of legal protection and benefits.

Choosing an appropriate business structure that meets your needs is an important decision

There are five types of business structures: sole proprietorship, partnership, Limited Liability Company (LLC), C corporation and S corporation.

1 Sole proprietorship

A sole proprietorship is the simplest way to organize a business. It is the least expensive to set up and register and the easiest to manage, due to less onerous government reporting requirements. In this business structure, the business owner has complete control over business decisions and receives all of the profits earned by the business.

In this structure, the business owner is usually considered to be self-employed. Little or no capital is required to set up the business, but raising capital later may be difficult due to the inability to issue shares in exchange for capital.

As a sole owner, the business owner is personally responsible for all debts and obligations related to the business; this is referred to as unlimited liability. This means that the owner's business and personal assets are subject to claims by creditors to satisfy any unpaid debts.

All profits go directly to the business owner, so net business income is taxed as personal income. The business owner must file a personal tax return to report all business income or losses. If the business is performing poorly, business losses can be deducted against other income, such as investment or rental income, generally up to 80% of taxable income with any unused amount carried forward for up to 20 years.

In a sole proprietorship, the owner generally performs all of the functions required to set up and manage the business. It may be difficult to attract other employees, and when the business owner wants to retire it will likely be difficult to ensure the continuity of the business.

2

Partnership

A partnership is a non-incorporated business established by two or more persons to combine their resources and share in the profits and expenses. This type of business organization is usually easy to set up and manage, but it is highly recommended that a written partnership agreement is drafted at the beginning of the relationship between partners to address operating procedures.

This business structure combines the financial resources and the unique skillsets of the business partners. While this means there are "more hands on deck" to control and manage the business, the division of authority may potentially lead to disagreements or conflict between partners when making important business decisions.

The written partnership agreement is a useful tool for managing the business effectively and minimizing conflict. This legal agreement should clearly define the terms of the business, provide a process for conflict resolution, state how profits or losses will be shared and describe the steps and outcome of the dissolution of the business. It is important to seek the advice of a legal professional when drawing up a partnership agreement to ensure the protection of the individual interests of the partners.

There are two types of partnership: general and limited. The extent of personal liability for each partner is dependent on the type of partnership. In a general partnership, each general partner is jointly and personally liable for all the debts and obligations of the partnership. This is known as unlimited liability. In a limited partnership, a limited partner can contribute to the business without being involved in its day-to-day operations, and so is usually not personally liable for the debts of the business. A limited liability partnership is sometimes used by professionals such as lawyers, accountants and doctors.

The partners of the business will share in all the profits and losses of the business, and these will flow to the individual partners. The individual partners will report their share of the net income or loss on their personal income tax return. A general partner's share of the earnings will be treated as self-employment income and subject to self-employment tax as well as income tax. A limited partner does not pay self-employment tax unless they receive guaranteed payments for services and then only to the extent of those payments.

It can be difficult to raise additional capital for the business from third parties unless a valuation of the partnership can be established and additional partnership units issued. Such capital may need to be sourced from operating profits or the partners' own personal assets.

Compared to a sole proprietorship, business continuity in a partnership is easier as it is less reliant on one individual. Hence, it is important that a partnership agreement is in place to describe how to deal with the exit of one of the partners from the partnership.

If you are considering setting up your business as a partnership or investing in a partnership, you should consult with legal and tax professionals for advice.

3 Limited Liability Company

LLCs have become popular over the last 20 years. Many real estate ventures use the LLC structure. LLC owners can have limited liability. This means that members are generally not personally liable for the actions of the LLC. The owners are required to follow general business protocols such as record keeping and segregating personal and business assets.

An LLC can have one or more members. If there is only one member, it is referred to as a single member LLC and is taxed like a sole proprietorship unless the owner elects to be taxed as an S or C corporation. If one of these elections is not made, the business income will flow to the owner's personal tax return with no separate income tax filing for the business. Similar to a sole proprietorship, business losses may help offset other personal income. If there is more than one member, unless one of the corporate elections is made, the entity will be taxed similar to a partnership where a separate tax filing is necessary at the entity level with the owners reporting their allocable share of income and losses on their personal tax return.

An LLC can be member managed or manager managed. If it is member managed, the owners share in the day-to-day decision making. If the owners are not experienced in such decision making, a professional manager can be hired. While there is some discord (and the IRS rules are not clear), generally LLC members that are active in the management of the business will likely report self-employment tax on their share of the business income while non-active LLC members may not. Both types of members are subject to self-employment tax on top of income tax on any guaranteed payments for services received.

Start-up costs and fees for establishing an LLC are reasonable; however, in the case of a multi-member LLC, it is highly recommended to have an operating agreement drafted with all appropriate provisions similar to a partnership agreement for the same reasons. There will also be ongoing annual paperwork and administration as an LLC is a state registered entity.

The ability to raise capital by issuing additional member interests (like stock in a corporation) is easily accomplished; however, as most entities using an LLC structure are smaller in size, debt capital is often required to be personally guaranteed. Business continuity can be interrupted by laws in some states depending on member turnover so any operating agreement dealing with succession should account for specific state laws where the business operates.

4 C Corporation

Corporations are complex, with more onerous reporting requirements, and thus tend to be expensive to set up and operate. Depending on where a corporation operates, additional federal and/or state incorporations or registrations may be required, resulting in more legal and accounting fees. Many public companies are structured as C corporations. These corporations are heavily regulated, which leads to a number of reporting and disclosure requirements such as detailed tax filings. This type of business organization is considered to be a legal entity that is separate from its shareholders but controlled by the shareholders and directors of the business. A corporation has the same legal rights as an individual, so it can borrow or lend, incur legal liability and continue operating as a business on its own without relying on any one individual.

A significant advantage for the shareholders of a C corporation is limited liability. The shareholders are generally not personally liable for any of the debts and obligations of the corporation, and their personal assets can be protected from creditors. C corporation shareholders can benefit from reduced tax rates for business income received by the corporation in the form of qualifying dividends or capital gains; however, there is also tax at the entity level – so, there is a double layer of tax on business income when distributed. Unlike a sole proprietorship, LLC or partnership, C corporation losses cannot be used to offset income on a shareholder's personal tax return.

The shares and ownership of a corporation can be easily exchanged with the sale and purchase of corporate shares, and this is advantageous for the business continuity of a company structured as a corporation. This exchange makes it easier to raise capital for the business and also will not impact the continued operation of the corporate business during the exchange. It is advisable to seek professional tax and legal advice before incorporating a business.

S Corporation

An S corporation is somewhat of a hybrid between a C corporation and a partnership. They are limited to 100 owners which may be a drawback for raising significant capital. They can only have one class of stock (as voting shares) which may also hinder capital raising.

On the plus side, the S corporation structure avoids the second layer of tax as business income and losses are passed through to the individual shareholders for reporting on their personal tax returns similar to a partnership. The one significant tax difference between general partners/LLC managing members and S corporation shareholders, is that the distributable income of the S corporation is not self-employment income to the S corporation shareholder.

Owners of S corporations have limited liability. As with other smaller businesses, implementing a shareholder agreement, especially when there is more than one shareholder, is important to document operating, business succession and liquidation procedures.

S corporation owners have all the other administrative obligations (so there are similar costs and fees) like C corporations and it is advisable to consult a professional for tax and legal advice before incorporating as an S corporation.

Changing the business structure

There may be circumstances, personal or business-related, when it may be appropriate to change the business structure of a company. Some conversions may be simple, such as moving from a sole proprietorship to a partnership, but others may be more complex and costly, such as transitioning from a proprietorship or partnership to a corporation. You may consider changing your business structure as your business develops and circumstances change, but you should seek professional legal and tax advice to determine if it is beneficial and how to do it effectively.

It is important to consider your future needs and goals and attempt to build in flexibility to whatever structure you choose in case a change is needed.

Conclusion

Choosing an appropriate business structure that meets your needs is an important decision and will depend on your personal and business situations. Working with experienced advisors, such as a legal professional and a tax accountant, can help you identify and set up the business structure that is most appropriate for you and your business now, and in the future as your business develops.

Choosing between a pass-through entity (sole proprietorship, partnership, LLC or S corporation) and C corporation structure…

It's often said, "it isn't how much you make, but how much you get to keep…" Before 2018, avoidance of the double taxation paradigm of a C corporation structure was the knee jerk advice a business owner encountered when querying which structure to use in starting a business. Also, the C corporation tax bracket for business income might have been higher than an individual's tax bracket for the same income if it weren't taxed at the entity level. The Tax Cuts and Jobs Act (TCJA) of 2017 dramatically changed this paradigm, or at least the analysis involved when choosing an entity structure where taxes are a main driver in making a decision. Similarly, many pass-through business owners are reconsidering their original choice of entity.

Since TCJA became effective, the corporate tax rate was lowered to a flat 21% from a bracketed structure where the top rate was 35%. At the same time, the highest individual income tax rate was only lowered from 39.6% to 37% (a business owner of a pass-through entity may also face an additional 3.8% net investment income tax (NIIT)). Because of this disparity in tax law changes, a new pass-through business deduction was created as part of the TCJA. This new deduction is complex. It essentially allows certain pass-through business owners to deduct up to 20% of their share of qualified business income. The complexity comes in the application of the rules surrounding the deduction in that, depending on the nature of the business and income level of the owner there are limitation and exclusions that cause the pass-through business deduction to be less than 20% and in some cases 0%.

Even with the benefit of the pass-through deduction, a pass-through business owner's effective tax rate can be higher than the 21% corporate rate; however, the business owner must now consider the impact of double taxation on a corporation's effective tax rate. If the corporation distributes its income to the owner who pays 23.8% on that distribution 920% qualified dividend rate and 3.8% NIIT). Thus, double taxation can still bring the overall C corporation effective rate above the owner's effective rate.

Yet, savvy C corporation owners know that the effects of double taxation can be avoided, or at least deferred, by paying out the business income in the form of salary or by reinvesting the earnings in the business. The reason the double taxation is actually deferred rather than avoided is found when the business is to be sold. Because most buyers want to avoid contingent liabilities and receive a step up in basis for the corporation's assets, they will require a sale transaction to be structured as an asset sale. In this scenario, the gain on the sale will still be taxed twice: once at the corporate level and again when the proceeds are distributed to the owner.

As you can start to see, which type of entity selected (pass-through or C corporation) can be driven by the short and long term goals of the business itself or it could be affected by the fact the C corporation tax rate change is permanent and the individual tax rate changes are set to sunset in 2026. If your business doesn't intend to distribute earnings and retained earnings won't call for an accumulated earnings, tax or personal holding company tax, or your owners aren't eligible for a sufficient pass-through deduction, or you don't intend to sell the business, or you expect the TCJA to sunset – you might choose C corporation status; otherwise, pass-through entity status may be the way to go.

Determining your business structure must account for tax and nontax considerations. It is also a complex analysis to say the least. Given the recent tax changes, it is especially recommended for business owners to reach out to their tax advisor regarding their choice of entity.

Reducing risk to you and your family as a business owner

Unforeseen events, such as illness, disability or death, can have a devastating effect on a business owner and their family. Insurance is an important part of a comprehensive wealth management plan, and helps to provide financial protection for individuals, their families and their businesses against the unexpected. It is also a risk-management tool that provides a business owner or incorporated professional multiple benefits, including the potential for significant tax savings.

There are several insurance strategies that may be integrated into your wealth plan to supplement retirement savings, maximize the value of your estate and help protect you, your family and your business.

Supplement your retirement using the corporate owned life insurance (COLI) retirement strategy

As a business owner or incorporated professional, a large portion of your net worth is likely tied up in your company. Even if you have maximized the tax-sheltering opportunities provided by your qualified retirement plans selected for your business, you may still want to consider additional options to help fund your retirement by accessing the funds accumulated in your company. Implementing the COLI retirement strategy with a life insurance policy can help you accomplish this by providing several key benefits:

- Life insurance protection
- Management of investment risk
- Tax-deferred growth of funds
- Potential tax-free access to those funds in the future
- Potential tax-free benefit for your estate

To implement the COLI retirement strategy, your company purchases a life insurance policy on your life. Premiums are structured to build cash value within the policy, so that investment earnings are tax-deferred until they are withdrawn. The premium payments will not be considered a taxable shareholder benefit if your company is both the owner and beneficiary of the life insurance policy.

When you retire, the life insurance policy is leveraged to access its cash value. Leveraging involves having your company arrange a loan or line of credit using the cash value of the policy as collateral. The leveraged funds are used to make a non-taxable distribution, taxable dividend, or bonus payments to you – depending on your entity structure.

Generally, a significant amount of the cash value within the policy can be borrowed. The company will be charged interest on the loan, but often this can be covered by an additional loan. The total borrowing must remain within lending limits based on the accumulated cash value within the policy to prevent your policy from terminating.

For this insurance strategy to provide the most benefit, you should put it in place well before you retire in order to accumulate sufficient cash value in the policy to generate the income you'll require.

Tax-efficient succession planning using the corporate asset transfer strategy

Often, business owners let assets accumulate inside their company to take advantage of lower corporate tax rates, or use in future expansion or capital needs. This often means overexposure to fixed income investments. The corporate asset transfer strategy helps to diversify your company's portfolio without sacrificing liquidity, while simultaneously maximizing the value of your estate that is passed on to your beneficiaries. This strategy can also provide a flexible tax-sheltered investment vehicle for any cash flow surplus in your business.

Your company purchases a life insurance policy on your life, and transfers a portion of its fixed income investments to the insurance policy. The policy's tax-sheltering characteristics prevent the substantial erosion of the value of these investments each year. Eventually, when the death benefit is paid, it may be received tax free by the business. The amount that exceeds the adjusted cost base of the policy could be passed on to your beneficiaries' tax free.

Protect yourself, your family and your business

Retirement, illness, disability or death of key personnel can have a major effect on the continuity of your business. There are several insurance strategies that can help to manage such life changes for you, your partners and key employees.

Key person insurance is an effective way to help protect against the loss of an individual critical to the success of the business, whether they leave by choice or due to death, illness or disability. The policy should cover the estimated financial loss to the business as a result of the loss of the key person.

Buy-sell agreements (often times the provisions of which are found in your operating agreement) between business owners offer a degree of protection. In the event of your business partner's death or disability, life insurance is a cost-effective way to fund a buy-sell agreement to purchase shares from your partner's heirs. The premium can be low in comparison to the lump sum that will be paid out to inheriting shareholders for share redemption. Your company may not be taxed on the lump sum, and you could avoid using your personal or business assets to buy out your partner's share of the business.

Life insurance

These strategies use life insurance to protect the company, business owners and their families. There are two general types of life insurance policies: term and permanent – each having their own variations. Both types can be used to ensure the continuity of your business and the financial protection of your family.

Term insurance

Term insurance, such as policies for level, decreasing, increasing, or survivorship term life, can provide a tax-free lump sum payment to the named beneficiary or beneficiaries of the policy, if death occurs within the policy's term. This can cover funeral expenses, settle outstanding debts or mortgages, and help to replace the income of the deceased. For a business owner, term life insurance costs less than permanent life insurance. This reduces pressure on your capital and can help ensure you have the funds to keep your business going if you, a business partner or a key employee should die unexpectedly. There can be an option to transition to lifelong protection with permanent insurance when the time is right (convertible term), without having to answer additional medical questions. Term insurance can be used as a cost-effective solution for funding a buy-sell agreement.

Permanent insurance

Permanent insurance, such as policies for whole, variable, universal, or survivorship life, provides lifetime coverage, as long as the premiums are paid. It can be used for estate preservation, business succession planning, supplementing retirement income, income tax reduction and paying one's final taxes and estate settlement costs.

Premiums for permanent life insurance are higher initially than for term insurance, but generally don't increase with age or if your health status changes. In addition to the life insurance component, there may be an investment component. Permanent insurance is a key component of the COLI retirement and corporate asset transfer strategies.

Disability and critical illness insurance

You, your partners and key employees may be vital contributors to your business. But what if one of you became seriously ill or disabled and was unable to work? Such an unfortunate event could have a serious impact on your livelihood and your business.

Disability insurance is designed to help mitigate risk by providing your business with financial support if you or a business partner can no longer work or perform duties because of an illness or injury. If this were to occur, you would receive a monthly payment after a waiting period has passed.

Critical illness insurance pays out a lump sum amount if diagnosed with one of a specific list of illnesses, such as cancer, heart attack or stroke. Once approved, the tax-free lump sum benefit can be used to pay off your mortgage, supplement an income of a spouse or partner who takes time off to help support you, for specialized medical treatments, or to provide funds to sustain operation of your business while you are away from managing the business recovering. Receiving this lump sum shouldn't affect eligibility for other disability benefits from the company or some government programs.

For a business owner, a disability or critical illness insurance policy could cover overhead expenses related to running your business (as could business interruption insurance) and also help pay for costs such as rents and employee salaries. It can also be used to fund a buy-sell agreement. These insurance policies provide a safety net to allow you to focus on your health while your business continues to operate without affecting your other investments and goals.

Regardless of your age or stage in life, insurance should be part of a comprehensive wealth management discussion

Conclusion

You have worked hard to build your business, but an unexpected event like an illness, disability or death can have a devastating impact on you, your family and your business. It is important to plan for the unexpected, so that recovery can take place and the business can continue to function.

Regardless of your age or stage in life, insurance should be part of a comprehensive wealth management discussion. As well as providing protection against life-changing events, insurance can be leveraged to provide tax-efficient strategies for your company and for retirement. Speak with your BMO financial professional to assess your personal and business insurance needs.

Funding long-term goals: Retirement

Business owners face many unique challenges throughout their career. Given the uncertainties of the market, reduced diversification of assets and investments and the need to fund their own retirement, retirement planning is one of those challenges. But it does not have to be.

It is common for business owners to invest most of their assets and earnings in their business, especially during the start-up phase. For retirement, they often rely on selling the business or transferring it to a successor, or winding up the business and selling the assets. However, market uncertainties mean they should not rely on these methods to finance their retirement. By having a retirement contingency plan, business owners may avoid many potential risks.

For many people, the biggest worry about retirement planning is how to fund it. Much of a business owner's net worth is tied up in their business, resulting in a less diversified retirement portfolio. It is important to make an effort to diversify the pool of retirement capital, and there are a number of ways to achieve this.

Simplified Employee Pension (SEP) IRA

With this plan, the contribution limits are higher than with any other type of IRA; you can potentially put away up to $56,000 per year for yourself, depending on your income. In addition, you have the flexibility to not contribute each year, depending on the cash flow needs of your business. The percentage of salary contributed to all plans must be equal, so if you have employees, you're required to invest the same percentage of their salary in their accounts as your own salary.

Savings Incentive Match Plan for Employees (SIMPLE) IRA

Designed for small businesses with fewer than 100 employees, a SIMPLE IRA allows employees and employers to make contributions. Employees can choose whether or not to contribute, but as the employer, you must make matching contributions up to 3% of compensation or 2% non-elective contributions, so you will need to be committed to the plan year after year. In addition, the business (generally) cannot maintain another retirement plan in conjunction with a SIMPLE plan.

Traditional or Roth IRA

Anyone with earned income (and a nonworking spouse of spouse with sufficient earned income) can open an IRA (though there are income limits for Roth IRAs). Although these types of IRAs have the lowest contribution limits, you can set one up in conjunction with another retirement plan to increase savings. Traditional IRA contributions may be deductible and the distributions may be taxable. Roth IRA contributions are nondeductible, and the withdrawals are tax free.

Solo/Traditional or Roth 401(k)

A Solo solution allows a sole proprietor with no employees (except a spouse) to make contributions as both the employer and employee, potentially up to $56,000 (plus $6,000 catch-up if you're age 50 or older), depending on your income. Contributions as employee and employer may be fully tax-deductible, further reducing your income taxes. You can also establish the plan as a Traditional 401(k) or Roth 401(k), depending on your goals. Employees in a Traditional plan can contribute up to $19,000 pretax per year (plus catch-up contributions), commonly through payroll deductions. Business owners can make matching contributions to encourage employee participation, or profit sharing contributions based on cash flow each year, all of which are tax deductible for the business. There is no up-front tax savings in a Roth plan, but any growth and subsequent withdrawals are tax-free in retirement. Contributions to a Roth 401(k) are not subject to the income limits that apply to Roth IRAs. Employer matching contributions are pretax and may not be directed to the Roth portion.

Defined Benefit Plans

These plans allow you to contribute more than any other type of retirement plan. An actuary uses statistics, such as the age of the participants (you and your employees), salary levels and years until retirement to calculate the contribution limits. Older business owners with younger employees can potentially maximize benefits to their own accounts based on these calculations, in some cases resulting in allowable contributions of $100,000 or more. Contributions are fully tax deductible. If you're looking to save as much as possible, and have the cash flow to do so, a defined benefit plan may be right for you.

Retirement planning is an important process that business owners must make time for throughout their career. With the variety of funding options, it is best to speak to a BMO financial professional to determine the best retirement planning strategy.

Overcoming gender barriers to success in business

Operating your own business has its benefits, ranging from flexibility and independence to high income-earning potential. However, business owners also face many drawbacks, from the need to manage day-to-day operations and seek new opportunities to grow and expand to funding their own retirement, among many others. There is a great economic opportunity to support women and their businesses, but they are underserved.

Gender differences among business owners

Female business owners tend to be motivated by the necessity to generate income to meet their financial needs, and often start a business because they see a problem and they want to provide a solution. Whereas male business owners are more motivated by economic independence – to do what they want and when they want.[1] This is likely related to the finding that women tend to focus on building long-term business relationships and design their business to grow and adapt over time, while men tend to favor rapid growth in preparation for the future sale of the business. Contrary to popular belief about risk-taking, risk tolerance is influenced more by interest, confidence and desire for independence than by gender. However, women generally prefer to make risk-related decisions to advance their business interest, while men often see risk-taking as a means to achieve financial security.[1]

Opportunities to support female business owners

For women, there are often additional barriers that hinder business development. For example, they may face greater obstacles in acquiring loans from financial institutions. These financial barriers lead many women to self-finance their business, which may prevent them from growing their business to its full potential. Consider establishing a relationship with financial institutions well before loans are needed. Become informed and understand what is required to prepare a strong business case when seeking funds. Aside from financial obstacles, there are also social issues that still limit the degree to which women can focus their full attention to the operation of their business. Women are still disproportionately responsible for managing the household and they tend to be the primary caregiver for children or other family members.[2] Consider tapping into your network for support, seek mentorship opportunities or take advantage of programs that offer support, possible funding and additional business knowledge.

Women strongly positioned for success

Women entrepreneurs are profitable and the fastest growing segment in the U.S. Women represent a growing percentage of the work force, and the number of women who are self-employed and own an incorporated business has increased steadily in the last decade. Women are clearly thriving as business owners, but there are opportunities to support and enhance their growth.

To help female business owners, BMO has set-up key partnerships and sponsorships to support the women's market by optimizing on networking opportunities. Talk to your BMO financial professional to learn how we can help you succeed and achieve your personal and business goals.

[1] Are there gender differences among entrepreneurs?, BMO Wealth Insight, BMO Wealth Management, September 2016. https://wealth.bmoharris.com/media/resource_pdf/bmowi-gender-entrepreneurs.pdf

[2] Financial concerns of women, BMO Wealth Insight, BMO Wealth Management, March 2015. https://www.bmoharris.com/financialadvisors/pdf/Q1-2015-Wealth-Institute-Report-Financial-Concerns-of-Women.pdf

When is the **right time to sell?**

How should you prepare your business for a potential sale?

As a business owner, deciding when to sell your business takes careful planning, and you must take your long-term succession plans into account. Planning for the sale well in advance allows you to prepare your business so that you're in a position of strength to negotiate and maximize the proceeds of the sale.

Have a clearly defined strategy

In order to maximize the sale proceeds, pre-sale planning is key. Business owners often decide to sell for very specific reasons or in response to particular events, which too often may be negative. Major problems – known only to the owner – such as large capital expenditure requirements, changing market conditions, increased competition, working capital shortages, or age and health issues are around the corner and are prompting the business owner to sell. As a result, a high level of anxiety may exist during the sale process if the owner is anxious to sell before these concerns become reality, and full value potential will not be realized as buyers uncover these issues. In contrast to this all-too-common scenario, the decision to sell should be a long-term strategic decision, not a short-term reaction to negative developments.

Ideally, you should start to plan the sale of your business well in advance of actually selling. Once you have an effective plan in place, you can fine-tune it when the timing is right to sell. In this way, you will be better able to negotiate from a position of strength and to maximize the proceeds of the sale.

Before committing to a sale, it is very important that you understand the implications of selling. These questions can help clarify your motivations and ensure you have fully considered the implications:

- What is your motivation for selling at this particular time?
- What do you have planned as your encore?
- Are there alternatives to selling that may accomplish your objectives?
- Is the timing appropriate in terms of general economic conditions and your business's strategic position?
- Have you considered the personal and business tax implications?
- How will the net proceeds of the sale be invested and what return do you anticipate?
- Are you going to remain in a management position after the sale?
- Are you genuinely committed to the sale of the business?

After thoroughly exploring these questions, you can more effectively plan for the sale of your business. Remember that once a sale agreement is executed, the decision is likely irreversible. Before exposing your business to the market, you should clearly understand your reasons for selling, what you expect the sale to achieve, and how you will realize your objectives after the sale.

Positioning your business for sale

Having made the decision to sell your business, ensuring it is in the optimal condition will achieve the best possible price. To do this, you'll need to carry out an assessment of your company's strengths and weaknesses. There are a number of important areas that need to be reviewed.

Information

Access to information and updated record keeping plays an important role when dealing with potential buyers for your business. Providing timely and accurate responses to requests for information gives prospective buyers confidence about the stability of your business and their potential acquisition.

Management structure

In reviewing your management structure, consider these questions:

- Is there a full complement of capable managers in place who are willing and able to manage the business themselves, or under new ownership?
- How will existing management react to a change in ownership?
- What is the reputation of your team within your respective industry? How are they rated for reliability and integrity?
- Are there individuals within the management team who are key to the successful sale of your business? If so, what incentives might be used to ensure their full cooperation?
- Do business relationships rely solely on you? If so, are you willing to remain in the business after the sale in order to engage in a transition of these relationships?

A weak management team can be a detriment, so it may be prudent to postpone a sale until appropriate adjustments have been made to the management team if there are problems in these areas.

Financial statements

Review your financial statements to confirm whether they conform to GAAP. Additionally, consider that financial restructuring can result in a higher sale price. Redundant assets should be identified and either sold, or otherwise discarded. Consideration should also be given to the separation of real estate assets from operating assets. In some instances, a lease can be put in place and desirable real estate assets can be sold in a separate transaction to maximize value.

Corporate record keeping

The company's corporate records, such as its incorporating documents, minute books and share register should be organized, up to date and readily accessible. Copies of major contracts, such as leases and other important business documents should also be available. In preparing your company for sale, consideration must also be given to contingent liabilities and any outstanding litigation (pending or anticipated). Such legal matters should be dealt with prior to the sale, or clearly disclosed

at the outset of any discussions with a potential purchaser. Similarly, the company's tax status should be reviewed to minimize the likelihood of unanticipated income tax assessments on prior years.

Operational analysis

The perception of a well-run business is an extremely valuable asset at the negotiating table. In most companies, there are some problems that may have been overlooked, or had solutions that have been deferred. Any such matters should be corrected prior to selling the business. For example, are the corporate marketing materials and digital presence up to date? Is the plant clean and tidy, and are the machinery and equipment in good working condition?

Prepare your business so that you're in a position of strength to negotiate and maximize the proceeds of the sale

Other considerations

In addition to ensuring your business is in a marketable position, you must also understand your company's bargaining position. Analyzing your company's strengths and weaknesses allows you to better understand its position in the marketplace. Expect the purchaser to evaluate the company thoroughly, and be aware that any deficiencies will be subject to negotiation. Adequate preparation and/or disclosure at the proper time can help reduce the impact of any deficiencies that may exist.

Assess the prevailing economic conditions, such as interest rates, economic growth and industry conditions to determine the optimal timing for sale. A seller with a short-term sale horizon could find it difficult to obtain their desired price if economic conditions are not favorable at the time of negotiation.

Receiving an unsolicited offer to sell your business

At any time, a successful business owner can be approached with an unsolicited offer to buy their business. This offer can come from an industry leader looking for a strategically identified acquisition target, a broker who is working on behalf of a legitimate buyer or someone who is simply attempting to find their next business opportunity.

When dealing with an industry insider or a broker representing a legitimate buyer, ask the following questions to help you understand the other party's motivation before sharing any information about your business or your potential interest in selling.

- Why has your business been identified as a potential candidate for acquisition? The response should reveal how much the purchaser knows about your business.
- What is their capacity to finance a transaction? What would be their sources of funding?
- What is their acquisition strategy? Some purchasers are simply looking for a business that can accelerate their growth in a specific industry, while others may be shopping for intellectual property or product lines.
- Do they want to maintain your management team and staff? Most business owners feel a strong sense of loyalty to their staff and want to ensure that they will be taken care of by a new owner.
- Would they want you to continue running the business during a transition period? Generally, a relatively short transition period works best for both parties.
- How do they typically value the businesses they acquire? The purchaser may not tell you how much they are willing to pay for your business up front. But if you understand their valuation methodology, you can apply that knowledge to your situation without divulging confidential financial information.
- If other companies have been acquired by the prospective buyer previously, what has been their experience? Contacts within those businesses can tell you what worked well with the transactions and why.
- Are they considering other potential acquisitions at this time? This will give you a good indication of where you stand on their priority list. Serial acquirers usually have several deals in the works at any given time, and it could take a while before senior management is able to focus on your acquisition.

Taking the next step

If you're feeling comfortable with the prospect of selling your business after your initial conversations, a confidentiality or non-disclosure agreement should always be signed with the potential buyer before sharing any confidential information about your business. This will ensure that financial information and employee details are not made public.

Seek professional advice

If you are a business owner contemplating the sale of your business, setting your goals, visions and your exit plan early is critical for success. Once you decide to proceed with the sale of your business, consider engaging a professional advisor to assist you in the preparation and negotiations. Unlike purchasers, who may acquire a number of companies over time to fulfill a longer-term corporate strategy, most business owners have never sold a business and, consequently, may have difficulty separating the pragmatic decision-making role from the emotional aspects of the sale.

If you're considering selling your business, contact your BMO financial professional who can refer you to the appropriate professionals for assistance and advice.

Who will take over your business?

This question is an important part of the decision-making process for business owners hoping to sell their business. Every business is unique, so the right answer will vary, but there are a number of different types of potential buyers for your company.

Strategic buyers

These are buyers within the same industry, including competitors, suppliers, or even customers. They usually have strong knowledge of the industry and sales processes, such as the competitive landscape, regulatory considerations and other value drivers. Potential synergies may occur, allowing for smoother and less costly operation for the buyer. This type of buyer is more likely to be able to offer a higher price. Extra care should be exercised regarding the degree of competitive information that should be shared, and when, with these buyers.

Financial buyers

Financial buyers are generally private equity investors. With a short timeline for their investment, private equity investors usually buy a business, grow it, and then sell it at a premium. This allows their interest in enhancing business performance to align with that of the current business owner. However, financial buyers have a more conservative price range in order to reduce risk. Additionally, depending on factors including the strength of the management team, the owner may have to remain engaged in the business throughout the transition period and may be required to maintain a minority equity interest in the business alongside the buyer.

Internal buyers

These are people within the company, such as management or employees. The benefits of this type of buyer for the business owner are a smoother transition, less disruption in operations and more confidence in the ongoing leadership of the business. However, internal buyers will often provide payments over time as opposed to full payment of the purchase price.

Family buyers

Selling to family helps continue the legacy of the family enterprise and transfer shares to the next generation. The payment transaction can be less direct than for other types of buyer, and may be payments over time, estate freeze structures or funding through a mix of sweat equity and bank debt. However family dynamics may come into play, leading to disputes over the distribution of parents' estates to children and disagreements about business decisions between the older and younger generations. Open communication is especially crucial with this option to maintain family harmony and business health.

The type of buyer a business owner chooses depends on the size and competitive strength of their business, and their personal situation including the need for asset liquidity, hopes for the future of the business, and if they want to continue to be involved in business operations. To find the best strategy for exiting your business, talk to a BMO financial professional.

What's next for you? Building your legacy with a Donor Advised Fund (DAF) or a Private Foundation

Many owners find it difficult to part company with the business they have nurtured and developed into a successful enterprise. Having devoted so much time to their business it becomes a part of their identity, and it can be hard to replace the sense of purpose and fulfillment it represents. When the exit phase of the business life cycle approaches, many business owners will ponder what is next for them and for the business that has been their life's work.

After transitioning away from their business, many business owners struggle to manage their newfound freedom, and may experience a sense of loss of the identity and community that their business once provided. It can be a disappointing end to a venture that gave the owner pride and a sense of accomplishment. A thoughtful transition should be a multi-year process that provides ample opportunity to focus on how to use that freedom to provide purpose and community, and to transform the business into a lasting legacy.

The key to this process is to find activities that match your values and interests. One way to provide identity and community post-business – and to enhance your legacy – is to explore charitable giving.

Do you want to have a sustained impact on your community or in an area that interests you? Would you like to take a strategic approach to your giving? Do you want to involve other family members in your giving, or to pass on your philanthropic values to your children and grandchildren? There are many ways to give meaning and structure to your philanthropy and a DAF or a private foundation are two such ways.

What is a DAF?

A DAF is a giving vehicle established at a public charity (these include national charities, community foundations, and single-issue charities). It allows donors to make a charitable contribution, receive an immediate tax deduction and then recommend grants from the fund over time. Donors can contribute to the fund as frequently as

they like, and then recommend grants to their favorite charities whenever it makes sense for them. You may name your DAF account, its advisors and successor advisors, and manage the underlying investments.

What is a Private Foundation?

A private foundation is a philanthropic vehicle that is constituted and operated exclusively for charitable purposes, and can be structured as a trust or a not-for-profit corporation. It fulfills its charitable purposes through the controlled disbursement of its assets to listed tax exempt organizations or other "eligible donees."

Private foundations have restrictions on self-dealing between the foundation and their substantial contributors or other disqualified persons. Violations can give rise to taxes and penalties against the foundation and, in some cases, its managers, substantial contributors, and certain related persons.

Choosing between a DAF and a Private Foundation

Below are some high-level guidelines to help you compare a DAF and a private foundation.

- Making a minimum contribution of approximately $5,000 – $50,000 (account minimums differ by sponsoring charity and/or DAF program)
- Seeking a simple, fast and inexpensive way to form a charitable giving vehicle
- Looking to maximize your charitable giving income tax deductions
- Contributing closely held stock, publicly traded stock, real estate or cryptocurrency that has appreciated in value, especially if you want a larger tax deduction
- Seeking greater flexibility in the annual amount of your grant making, including the ability to forego making any grants in some years
- Looking for greater privacy in your grant making, including keeping the balance of your charitable giving vehicle private

Although a DAF offers lower administrative and management fees, more favorable deduction limitations and asset valuations, and no excise tax on investment income, a private foundation provides greater control in the areas of grant making and investing. This is because a donor to a DAF must surrender final discretion and control over contributed assets, retaining solely advisory privileges.

A charitable sponsor of a DAF typically offers several investment pools into which you can allocate funds for investment (although most charitable sponsors will permit independent and active management of a DAF account if it has a minimum balance determined by the charity — typically $250,000 to $1 million). On the other hand, you may retain complete control of the investment of funds in your private foundation within the foundation's documented rules; private foundation investments are not limited to a selection of investment pools. In addition, as a donor to a private foundation, you can exercise full control over grant making. With a DAF, the charitable sponsor has the legal right to approve or deny a grant and makes all the final decisions. However, it's important to note that you can make recommendations, and in practical application, the charitable sponsor generally approves recommendations for grants to 501(c)(3) public charities.

Finally, as a donor to a private foundation, you may appoint its board members, including family members, providing the opportunity for your family's future generations to participate in its legacy through philanthropy. A private foundation may operate in perpetuity, and successive generations may serve on the board. A private foundation exists until its board votes to dissolve and unwind its operations.

How is a DAF or Private Foundation established?

A DAF can usually be established immediately by filling out an application, having it approved by the sponsoring charity and making a deposit. In addition, there are typically no start-up fees.

With a private foundation, an attorney drafts articles of incorporation and bylaws (or a trust document), and registers the foundation with the state. The foundation must also apply to the IRS for recognition as a tax exempt organization. Legal fees and other start-up costs can be several thousand dollars and typically takes several weeks to create. As a result a private foundation is best suited to those willing to fund it with at least $2 million.

To enhance your legacy – **is to explore charitable giving**

How do you operate a DAF or Private Foundation?

The operations of the DAF are dictated by the sponsoring charity. Timing and minimums may apply to grants. Typically, simple forms are used for the donors to advise on the ongoing investments and grants. There are typical ongoing administration and management fees ranging between 60 – 100 basis points for accounts under $500,000 and 30 – 75 basis points for the next $500,000. This also varies by the sponsor and level of services.

The operations of a private foundation are generally managed by directors or trustees. While the investment of the assets of the foundation can be managed by the trustees and directors, in many cases these powers are delegated to an investment management firm. Federal law requires that 5% of the net assets valued annually are disbursed each year to qualified charities or a penalty is imposed. A professional investment manager can be retained to ensure that capital growth is maintained, and the 5% disbursement quota is met from the annual investment revenue. Private foundations must also file detailed and public annual tax returns (there is an excise tax on investment income of 1% – 2%) and may need independent audits. If you outsource ongoing administration and management, the costs can add up to 1% of assets.

What is the tax treatment of gifts made to a DAF or Private Foundation?

Gifts to a DAF are valued at fair market value for cash, stock, and real property held over one year. You can deduct up to 60% of your adjusted gross income (AGI) on cash contributions and 50% of AGI on mixed cash/noncash donations (gifts of stock or real property held greater than a year can be deducted up to 30% 0f AGI). Unused deductions can be carried over for up to five additional years.

Gifts to a private foundation are valued at fair market value for cash, and certain publicly traded stock held over one year (gifts of closely held stock or real property are valued at cost basis). You can deduct up to 30% of your AGI for contributions to a private foundation (gifts of stock or real property held greater than a year can be deducted up to 20% 0f AGI). Unused deductions can be carried over for up to five additional years.

Many DAFs and private foundations are created to coincide with a significant event in the founder's life, such as the sale of a business. The sale of a business can result in a tax liability as well as significant cash proceeds so the establishment of a DAF or private foundation at this time can provide some personal tax relief for the business owner. For more information on the tax treatment of gifts made to a DAF or private foundation, you should seek advice from a professional tax advisor.

Transitioning away from your business is not easy; pursuing philanthropic interests can be rewarding for you as a business owner who is proud of the legacy you have created. Giving shape to your charitable giving through a DAF or private foundation can be gratifying, and a learning experience that complements the satisfaction you have achieved from your business endeavors. Planning in advance can make this philanthropic journey easier, so we suggest that you speak with one of our philanthropic advisors at BMO Wealth Management about whether a DAF or private foundation is the right choice for you.

Giving back

There are many ways to give back as you near the exit phase of your business. While starting a donor advised fund (DAF) or private foundation are popular methods to create a legacy for your family, other strategies may better fit your needs and situation. Aside from the benefit of helping others, a major benefit of charitable giving can include tax deductions that may be claimed for up to 60% of your adjusted gross income for the year (and carried forward for five years after that). Generally, almost any property of value can be contributed as a charitable donation, with some restrictions around non-cash gifts.

Donate directly

Donate cash or other assets to a charity's general fund for unrestricted use, or to a restricted fund for a specific project.

Donate through your Will or Trust. Make testamentary gifts to charities in your Will or Trust by giving a set dollar amount or a portion of your estate or trust.

When you donate qualifying publicly-traded appreciated securities directly to a charity, tax on any capital gains can be eliminated. The tax that would have incurred on the eventual sale of the security would be avoided.

Life insurance

Donating a life insurance policy to a charitable organization is another popular strategy for giving back. Common options to do this are:

- Make the charity the beneficiary – upon death, the charity would receive the death benefit proceeds and the insured's estate would receive a tax deduction for the full amount of insurance proceeds. If you have a taxable estate, this may be tax inefficient.
- Make the charity the owner and beneficiary – a donation receipt based primarily on the cash surrender value of the policy is issued and all future premiums paid by the insured are considered charitable donations eligible for a charitable deduction.

Life annuity

Donating a life annuity is a good way to make a significant gift without impacting your income needs. The benefactor would use a portion of his/her capital to buy a life annuity to provide a lifetime stream of income, and the remaining capital could be donated to a charity.

Designate a charity as the beneficiary of your Individual Retirement Account (IRA) or 401(k)

Charities do not pay income tax on donations they receive from these accounts. However, you may need spousal consent in the case of a 401(k); check your state's laws.

Business owner strategies

Charitable Remainder Trust (CRT): As an alternative to a taxable business sale, the owner could contribute all or a portion of their interests to a CRT and receive a charitable deduction. The Trust would sell the company's interests or liquidate (gains would be tax exempt) and use the proceeds to provide the owner with income for their lifetime, after which, the Trust would terminate and transfer its remaining assets to the charitable organization(s) they had chosen. Income payments would be based on a percentage of the Trust's annual value.

Charitable Lead Trust (CLT): Many business owners use gifts to charitable Trusts to leverage the income tax impacts when selling an appreciated business and the sale of a business could be a windfall where use of a CRT is not permitted from a timing standpoint. A CLT is beneficial if the business owner or his or her family members do not need an income stream at the time the Trust is created. Upon creation, the charity would receive the income stream and, at the end of the term, the remaining assets would pass to noncharitable beneficiaries. The value of the income stream going to charity for a term of years may create a charitable deduction at the time the Trust is created or each year during the term, depending on the structure of the Lead Trust.

With numerous avenues for charitable giving, choosing the right option for you may be challenging. Let your BMO financial professional help you with your giving options to ensure a rewarding giving experience.

Leaving your **mark**

"Only eat one steak a day, share what you have created and enjoy, and leave your mark in some small way" was Arnold Rosenberg's philosophy as he neared his retirement. This sentiment is common among successful business owners.

Arnold started his career as a systems engineer when computers were in their infancy and took up an entire floor of an office building. Frustrated with the bureaucracy in his civil service job, Arnold decided to start his own business. He opened an office to implement and market his ideas for software development. The business grew quickly to become a major developer and distributor of educational and scientific software with an international customer base.

At 61, Arnold began to think about exiting the business and ending his day-to-day management role. "You look in the mirror and you see a little grey hair and realize that you might not be around forever," he says. This realization is especially bittersweet for business owners, as it may mean letting go of the business they built from scratch.

Arnold knew this was an important stage in the life cycle of his business. "We put a lot of effort into getting trained and prepared for our careers… but very few people put the same time and effort into planning their retirement." Many people only start planning for their retirement late in life, but retirement planning should really be a career-long process. For Arnold, building his business gave him access to legal, financial and tax professionals who were knowledgeable about retirement. He took advantage of their expertise and planned for his retirement early. "At the time, it did take quite a bit of effort, but now I have the freedom to consider my options and my kids have the freedom to choose what kind of role they would like to play."

With a retirement plan already in place, Arnold had more time to focus on the transition of his business as he plans to exit. "Many people in my position are looking to their kids to carry on the family legacy, but I've always thought that puts an unfair burden on the next generation." With a son in banking and a daughter practicing law, Arnold believes that his children can choose their own career trajectories: "If they want to become involved with the business, it should be entirely their decision."

Since Arnold's children had not expressed strong interest in running the business, a share-option plan could be a good way to keep talent within the business. This would allow Arnold to provide employees with incentives while still retaining control.

Wanting a tax-efficient way to transition his assets to the next generation, Arnold set up a holding company jointly owned by his two kids. "They have no votes, but technically have all the financial benefits. It is essentially more of an investment portfolio than anything else," he explained. This strategy allowed him to eliminate the tax implications of his business for his estate. However, Arnold should also be prepared to use third-party mediators for conflict resolution if his children disagree about the business.

Today, Arnold continues to enjoy contributing to his business, and jokes, "it's quite possible they're going to end up having to carry me out." As his responsibilities in the company are transferred to new management, Arnold hopes to be more involved with charitable efforts in his community: "Perhaps, I could get a group of friends together and we could take on a project, doing what is required, and maybe using what influence I have – that's something I would really enjoy doing."

Aside from giving his time, Arnold plans to contribute some assets to charities he supports upon his death. "These will be anonymous donations – I have no interest in being known for my good deeds, but I feel there are certain charities that are deserving of my money." Alternatively, Arnold could consider creating a private foundation or donor advise fund to give during his lifetime. This will also help him achieve a personal goal of tax minimization.

With his proactive retirement and exit planning, Arnold has established a structure that ensures the stability of his business and gives his children the flexibility to make their own career decisions.

Acknowledgement

This client story is abridged from Sarah Kruger and Sean Foran, Succession Stories from the Front Line (BMO Bank of Montreal, 2008), 79–85.

Closing remarks

BMO Wealth Management provides services that can help you develop a customized wealth management plan tailored to your lifestyle and goals. Our strategies evolve as circumstances change to help deliver on your current and future wealth management needs. Our advisors work to understand your needs and to recommend a holistic wealth solution that encompasses your financial situation, your personal and family objectives and your stage in life.

Who do we help?

We serve a broad spectrum of clients, including ultra-high-net-worth and institutional clients, from individuals and families to business owners and entrepreneurs, professionals and executives, and corporations and institutions. We operate in the United States, Canada and in select global markets, including Asia and Europe.

For a business owner, we can help untangle your personal and business wealth plans, allowing you to focus on growing your business. We can also provide guidance on business succession planning when you are ready to move on to the next chapter in your life.

We understand the unique challenges professionals and executives face, from concentrated stock positions, stock options and controlled stock to special borrowing needs. We aim to simplify the complexities that can come with wealth and help build a comprehensive wealth management strategy.

Our wealth management approach is based on helping our clients plan, grow, protect and transition their wealth. We work with you to help develop solutions that match your needs.

Plan

A sound wealth plan is a vital component in achieving your current wealth goals and securing the financial future for you and your family.

Grow

Although no one can fully predict the future, our wealth management professionals will work with you to help you grow your wealth; you can also use our self-directed services to develop your own solutions.

Protect

The careful balance of risk and reward is one of the primary benefits of professional wealth management, helping to protect your portfolio from market volatility.

Transition

We will work with you and your family to put strategies in place to prepare for life changes and help to make unexpected transitions as smooth as possible.

BMO Wealth Management publications

BMO Wealth Management publishes a variety of financial, retirement, tax and estate articles that provide insights and strategies around wealth planning. Speak with your BMO financial professional about other BMO Wealth Management publications that can help you make sound decisions for a better financial future.

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