

## SMALL BUSINESS AND RED TAPE REDUCTION

### ADDRESSING BARRIERS TO SUCCESSION PLANNING FOR SMALL AND MEDIUM ENTERPRISES (2016)

According to a 2013 survey completed by the Canadian Federation of Independent Businesses (CFIB), 75% of Canadian business owners will exit their business before 2022.<sup>1</sup> The importance of succession planning and the creation of a business exit strategy remains critical. The top reason for exiting a business is retirement.<sup>2</sup> The economic impact of the retiring baby boomer generation of SME business owners should not be underestimated.

In the 2012 CFIB report: *Passing on the Business to the Next Generation*, it was estimated that over \$1 trillion in business assets would change hands by 2017. A secondary source identified that by 2022, \$3.7 trillion dollars of business assets will have changed hands.<sup>3</sup>

Innovation, Science and Economic Development Canada defines an SME when a business employs anywhere from 1 to 499 employees, which includes Micro-enterprises employing 1 to 4 individuals.<sup>4</sup> The large group of SMEs in Canada account for 98% of businesses, employ 48.3% of the labour force, and account for 40.7% of the GDP.<sup>5</sup> Yet, studies have proposed that only 10% of owners have a succession plan in place.<sup>6</sup>

A succession plan helps a business owner deal with complex topics such as:<sup>7</sup>

- tax issues;
- required qualifications and skills of successors;
- legal issues;
- how the successor will be trained/prepared for the role; and
- mechanics for the purchase or transfer.

Some of the top barriers to succession planning include but are not limited to:<sup>8</sup>

- Finding a suitable successor;
- Valuing a business;
- Financing for the successor; and
- Access to cost effective professional advice.

British Columbia's *Venture Connect* prepares businesses for a sale so they can be transferred to a new owner – keeping businesses in our communities. *Venture Connect* began as a project created in response to the challenge that over the next 20 years, there will be unparalleled shortfalls of both business owners and employees resulting in potential closure of large numbers of small businesses throughout the province. The project was supported by B.C. Ministry of Jobs, Tourism and Innovation, B.C.'s Small Business Roundtable, Island Coastal Economic Trust and six Community Futures organizations throughout Vancouver Island and the Island Coastal region (this includes Powell River and the Sunshine Coast). In 2013, *Venture Connect* began establishing working

1 Canadian Federation of Independent Businesses (2012) *Passing on the Business to the Next Generation*, page 3

2 Canadian Federation of Independent Businesses (2012) *Passing on the Business to the Next Generation*, page 8

3 Retiring business owners to transfer \$1.9 trillion in business assets in the next five years - largest turnover of economic control in Canadian history: CIBC

4 Industry Canada (2011) Cited in CBC News (2011) 10 Surprising stats about small business in Canada [www.cbc.ca/news/business/smallbusiness/story](http://www.cbc.ca/news/business/smallbusiness/story)

5 Ibid

6 Canadian Federation of Independent Businesses (2011) Unnamed Poll. Cited in CBC News (2011) Canadian businesses score poorly on succession planning.

7 Canadian Federation of Independent Businesses (2012) *Passing on the Business to the Next Generation*, page 4

8 Canadian Federation of Independent Businesses (2012) *Passing on the Business to the Next Generation*, page 4

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partnerships with Community Futures throughout the province and now delivers services throughout rural B.C.<sup>9</sup> Even with resources such as Venture Connect, SMEs have historically been, and continue to be, vulnerable with respect to receiving approval for financing from lending institutions. This not only includes entrepreneurs starting a brand new business, but also those looking to purchase an existing business, as in the case of succession.

In B.C., the Employee Share Ownership Plan (ESOP) and Employee Venture Capital Corporation Tax Credits provide tax-based incentives for investors to provide financing to businesses for a variety of purposes.<sup>10</sup> Tax-based incentives allow for employees to invest in companies and receive tax credits. While the money can be used by the receiving business for succession planning, there are severe limitations to the programs that have made them ineffective. At present, B.C. has provided the ESOP to facilitate direct investment by employees in their employer's company, and the succession ESOP which is a special application of the standard ESOP which facilitates a transfer of control of the business from the current retiring or departing owner(s) by involving the employees over a period of time. The succession ESOP also does not assist in succession of the large number of SMEs that are not incorporated or the many instances where the successor wants to buy the corporate assets rather than the shares.<sup>11</sup>

Another possible solution involves a slight modification to the existing B.C. Ministry of International Trade, Investment Capital Program, Eligible Business Corporation (EBC) tax program to support B.C.-based companies with succession. Specifically, this program could be modified slightly to support a vendor take back or owner financed business transactions by providing the retiring business owners with a 30% tax credit for the value of their financing provided to the new owner. Currently the EBC program is designed to help small to medium sized enterprises in B.C. attract private equity investment. The already existing Eligible Business Corporation (EBC) program which currently (as of January 2016) still has a \$48.33 million budget. There would be no additional costs associated with this policy, above and beyond what has already been budgeted.

Nationally, the Canada Small Business Financing (CSBF) Program is a federal government program with a mandate to increase the availability of loans for establishing, expanding, modernizing and improving small businesses by encouraging financial institutions to increase financing availability to small businesses, yet it does not include succession planning as a reason for a business financing.<sup>12</sup> A study conducted on behalf of the Business Development Bank of Canada (BDC) indicated trends of superior results by SMEs who obtain CSBF Program funding to SMEs obtaining funding elsewhere.<sup>13</sup> While CSBF does not currently allow for the financing to be obtained for the purpose of succession planning, BDC's study proved through historic evidence that financing programs to SMEs do work and help contribute to economic stability and growth.

Government backed financing should be considered in the format of the Small Business Loan Guarantee Program, but instead of guaranteeing loans to start up or expand a business, the loan guarantees to pay the vendor up to 75% of the value of the loan with a maximum loan value of \$500,000 to \$750,000.<sup>14</sup> The loan allows the purchase of the existing business assets or shares rather than new working capital, capital assets, or equipment required for a new business. Loan programs need to shift more attention to succession rather than wholly focusing on new business.

<sup>9</sup> <http://www.ventureconnect.ca/about/what-is-venture-connect>

<sup>10</sup> Farrow, A. (2012) Issues in Succession Planning for Small to Medium Enterprises in the Greater Nanaimo Area

<sup>11</sup> Heron & Company (2007) Review of SME Loan Guarantee Programs. Research Report: Industry Canada, CSBF. Ottawa.

<sup>12</sup> Statistics Canada (2009) Economic Impact Study of the Canada Small Business Financing Program. Report: Industry Canada, Ottawa.

<sup>13</sup> BDC (2011) SMEs At a Glance

<sup>14</sup> Brennan, M., Miksimovic, V., and Zechner, J. (1988) Vendor Financing. The Journal of Finance, 43 (5), pp. 1127-1141

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According to statistics from the Canadian Association of Family Enterprise, between 80 and 90 percent of all companies in Canada are classified as small to medium, and the majority of these are family owned.<sup>15</sup> While almost half of SME owners plan on selling to a buyer or buyers unrelated to them, over one third of them intend on selling or transferring to their family members.<sup>16</sup> Small corporations should be allowed to defer the tax on the capital gains from the transfer of a business to the owner's children.

Since 2013, several tax measures have been introduced to assist Canadian business owners with the transition of their businesses. The Lifetime Capital Gains Exemption (LCGE) is one very important tax measure because for many business owners, the sale of their business is their retirement income.<sup>17</sup>

The Lifetime Capital Gains Exemption (LCGE) is a federal tax deduction that can be claimed against taxable capital gains on the disposal by an individual of:

- Qualified small business corporation (SBC) shares;
- Qualified farm property; and
- For dispositions occurring after May 1, 2006 for qualified fishing property

The maximum LCGE was increased from \$500,000 to \$750,000 effective March 19, 2007 as a result of the Federal Budget that year.

The 2013 Federal budget increased the LCGE amount to \$800,000 for the 2014 tax year. The indexation of the LCGE to inflation for the tax years after 2014 was an important step in ensuring that the value of the LCGE's are retained. LCGE is \$813,600 in 2015 and \$824,176 for 2016.

The 2015 Federal Budget also increased the maximum LCGE for qualified farm or fishing property dispositions on or after April 21, 2015 to the greater of:

- \$1 Million; and
- The indexed Lifetime Capital Gains Exemption applicable to capital gains realized on the disposition of qualified small business corporation shares.

It would be prudent for B.C. to focus on stimulus for succession planning for small business that addresses the various business structures while keeping in mind that vendor's general desire to use the Federal Tax Act provisions to minimize tax on the transition.

Overall, the results of the Chambers research indicate a need for awareness to the issue of succession planning as well as changes to existing government resources for financing to provide sellers and potential purchasers the incentives to conduct succession planning and transition effectively.

Based on the information provided above, it is clear that the importance of business succession planning has been accepted by the senior levels of government in Canada and British Columbia as a relevant issue, and that further action by government to address this matter is timely.

### THE CHAMBER RECOMMENDS

<sup>15</sup> Keeping it in the Family: Third and Fourth Generation Family Businesses in Calgary, February 2016, Page 3 Christina Frangou

<sup>16</sup> Canadian Federation of Independent Businesses (2012) Passing on the Business to the Next Generation, page 3

<sup>17</sup> Canadian Federation of Independent Businesses (2012) Passing on the Business to the Next Generation

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That the Provincial Government and, where applicable, the Federal Government:

1. Create a task force in partnership with business and government to develop and implement improved access to simplified practical information regarding proper business succession practices for SME business owners;
2. Increase awareness, particularly among young entrepreneurs, about the opportunities and advantages of purchasing an existing business;
3. Expand the scope of current tax based incentives (such as the Succession Employee Share Ownership Plan) to include unincorporated businesses and instances where successors buy corporate assets rather than shares;
4. Review the current “qualifying activities” in the existing Eligible Business Corporation (EBC) program and
  - a. Include a clause which allows the program to be more inclusive towards small to medium sized businesses in a succession transaction; and
  - b. Include a vendor financed arrangement as a qualifying activity, whereby the vendor will receive the same 30% tax credit for financing the business succession transaction, thereby reducing the vendor’s risk;
5. Expand the scope of existing small business financing programs (such as Canadian Small Business Financing Program) to incorporate succession planning as a legitimate reason for business financing;
6. Expand the scope of existing government backed vendor financing programs (such as the Small Business Loan Guarantee Program) so that existing or potential owners of SMEs may access funds to facilitate the various aspects of succession planning including capital funds for purchase of an SME business;
7. Allow small corporations to defer the tax on the capital gains from the transfer of a business to the owners’ children; and
8. Continue to index the Lifetime Capital Gains Exemption to inflation and expand it to include some assets.