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This is the Private Wealth Podcast with Manulife Private Wealth.

Speaker Participants

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Leslie Brophy
AVP, Head of Investments and Sales, Manulife Private Wealth

John Natale
Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Dave Turnbull
Head of Private Company Advisory, Manulife Securities

Presentation

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Hello, everyone, and welcome to the Manulife Private Wealth Business Strategies for Small- and Medium-Size Enterprises conference call. This is special edition of our regular quarterly calls to provide you, our audience, with some ideas to consider as we navigate what our new normal is starting to look like following the onset of COVID-10. We are recording this call and a copy of the recording will be available to participants upon request. If you have any requests or questions after the call, please feel free to contact a member of the Manulife Private Wealth team. Let's start by introducing our panel.

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

Hello, everyone. My name is Leslie Brophy. I lead the team of Private Wealth Consultants and Investment Counsellors at Manulife Private Wealth. My team works closely with advisors to identify and introduce MPWs investment management services to high-net-worth prospective clients. For the most part, it's the advisors who identify these clients for MPW, based on specific criteria, as well as the advisor's belief that the clients would benefit from MPWs investment management services.

My team is located in Vancouver, Calgary, Montreal, Toronto and London. Today, I'll be speaking to you from the perspective of a Family Enterprise Advisor, a designation I earned earlier in the year and which helps business owners bring together and make sense of the dynamic interplay across business ownership, family and the business itself.

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Hi, everyone. My name is John Natale, and I lead the Tax, Retirement and Estate Planning Services team, or TREPS for short, on the Wealth Management side of the business. We're a team of accountants, lawyers and other specialists, some of whom are located regionally throughout the country that provides tax, retirement and estate planning support and consultation regarding complex cases across the country. Our goal is to help advisors help clients to do better planning.

Dave Turnbull, Head of Private Company Advisory, Manulife Securities

Hi, everyone. My name is Dave Turnbull, I'm the Head of Private Company Advisory in our Capital Markets group. Private Company Advisory is mid-market investment banking service. We advise on two types of transactions: mergers and acquisitions, and corporate finance. Specifically, raising debt and equity from institutional sources such as private equity and alternative lenders. We serve businesses valued at more than $10 million, and our objective is to create wealth for business owners.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Thanks, Dave. Like many of you on this call, our panel today has been speaking to customers, advisors and business owners during this unusual time to understand how they have been impacted by COVID. Nearly every business owner has talked about a negative or a positive impact to their business. They've also said they've been compelled to adapt their business model that was pre-COVID to be much more agile and digitally enabled.

Currently, several business owners have told us that they are trying to move beyond what was crisis management mode and are looking for ideas of how to adapt to this new normal. With that in mind, at MPW we thought it would be a timely discussion with our panel to talk about specific strategies business owners could consider when looking to the future.

Our discussion today will centre on three key themes in this new environment, which are ownership, business transition and philanthropy. These are great themes and personally I think they're regularly top of mind regardless of COVID. Let's start with ownership. What are your thoughts, Leslie?

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

Thanks, Glen. As you know, owners have extensive and powerful rights when it comes to the strategic direction of a company, given it's their investment dollars that sustain the business. These rights include, among others, how decisions are made and what leadership qualities are necessary for the company's success as it moves beyond crisis management and into the new normal. For family run businesses, ownership can be a prickly subject, particularly amongst family members or from generation-to-generation unless there is an open and honest communication regarding the future of the business.

Regardless of their situation in this new world, the generation who built the business faces some important decisions when looking to the future of the business, whether that's bringing on a family member as a co-owner or establishing a parentship with a colleague or competitor. Timing around these decisions and preparation for change can be crucial to the success of the partnership.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Could you expand a bit on what you mean by preparation for change, Leslie?

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

For sure. And I know Dave is going to into this from a financial perspective in a just a moment. However, as a Family Enterprise Advisor, I can't stress enough the importance of planning for the future during the in between times. That is, when things are going smoothly and there's no pressure to change the business model. However, as we all very well know, so many business owners say their carefully thought out long-term plans go out the window with the lockdown and are now working to get past crisis mode by considering various scenarios of how to adapt their business model for the future.

Those who have been able to pivot and adapt to the digital environment during this lockdown are likely to stand a better chance once the second wave hits. Advisors can play a key role by helping their clients understand how their core personal and business needs have changed through COVID and continue to demonstrate their value as a trusted advisor through their ongoing holistic planning.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Thanks, Leslie. So, the key messaging here is change readiness and business agility. Dave and John, I know you have some ideas for business owners to consider from a financial and tax perspective. Let's start with businesses that have been negatively affected by COVID. What are you suggesting, Dave?

Dave Turnbull, Head of Private Company Advisory, Manulife Securities

If you're a business that's been negatively affected by COVID, like businesses in travel and retail, you need to develop a plan. Your plan needs to consider both cost savings as well as potential new opportunities. So examples of cost savings might include reducing payroll, reducing office space and capacity, and even negotiating interest in principle holidays with your bank. Also consider some ways to generate liquidity, such as selling underutilized assets and excess inventory, or taking advantage of government subsidies in that there are several funds and programs that have been launched since March. Be sure to plan for new opportunities where COVID might be the catalyst for change.

Here are some ways you might evolve your business. Retrain employees, renovate facilities, develop or improve ne products or services, building new channels to markets such as selling online or expanding geographically. Be sure to build a technology platform to accomplish these changes. These changes may require investment in your business, so estimate the future profitability and ROI as that will be important to new investors and lenders. Ensure that you have the capital and liquidity with enough of a contingency fund to execute quickly. Once you've defined your plan, be sure to communicate with all stakeholders to let them know how you're strengthening your business. Stakeholders may include board, management, employees, customers, suppliers, investors and lenders.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Let me paus you there, as I know John has some thoughts to share on those business owners that have been negatively impacted by COVID.

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Thanks, Glen. Building on Dave's comments regarding companies that are distressed, I would suggest planning for worst case scenario and specific any potential personal liability. While some situations involving personal liability may be more obvious, such as when one personally guarantees a loan, others may not. I'll explain.

Generally, the CRA cannot pursue one person for the tax debts of another person. And under the law, incorporations are considered a separate legal entity or distinct person from their shareholders. This means that shareholders are generally not liable for the debts of their corporation unless they provide a personal guarantee. However, many shareholders are also directors of the corporation and there are instances where directors can be personally liable, such as if their corporation fails to remit the employee source deductions and GST and HST remittances to the CRA. As well, directors can be personally liable for statutory debts such as unpaid wages of up to six months for each employee and vacation pay. This is often referred to as director's liability and is over and above any potential liability for any personal guarantees given by an individual.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

John, is this what some people call piercing the corporate veil?

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Yes, exactly. Further to that point, a recent case has clarified a significant personal liability issue for corporate directors, and not in a good way. The recent Federal Court of Appeal decision, Colitto, clarified that directors' liability starts immediately following the corporate default. This is an important timing point, because once the director's liability crystalizes, those directors become classified as tax debtors themselves and are thereafter precluded from attempting to judgment-proof themselves by, for example, transferring assets like a house for less than fair market value to a related party such as a spouse or child prior to the CRAs technical issuance of a director's liability assessment.

In fact, these are almost exactly the facts on the case that I'm about to speak to, called Colitto. In that case, Mr. Colitto failed to remit source deductions in 2008. Later in that same year, I guess Mr. Colitto realized that he might be exposed to personal liability as a director, he transferred two properties to his wife for $2.00 each. The fair market value aggregate, or combined, was about $230,000. Obviously, I think we all know what Mr. Colitto was trying to do here, he was trying to protect his personal assets in case CRA came calling.

In face, that's what happened. The CRA issued a notice of assessment against the corporation in 2008. They weren't able to collect anything, they got a judgement, they got a writ, the Sherriff tried to execute the writ in 2011 and was unsuccessful. Then the CRA issued a notice of assessment against Mr. Colitto in 2011. I assume that they were also unsuccessful in collecting the debt against Mr. Colitto, but they came across the transfers of the two properties to Mrs. Colitto, and in 2016 they issued a notice of assessment for Mrs. Colitto.

You might be saying to yourself, "Really, can the CRA actually do that?" And in fact, they can. There is a specific provision in the Income Tax Act under section 160 that deals with such transfers. There is a couple of criteria that I will go through with you quickly. If a tax debtor at the time transfers something to a related party – so in this example Mr. Colitto transferred to his spouse – transfers something to a related part for less than fair market value – which was definitely the case here, he transferred two properties worth $230,000 for $2.00 each – then the recipient is also liable up to the different between the fair market value and the consideration provided.

So, Mrs. Colitto appealed and went to the Tax Court of Canada. And the Tax Court of Canada actually sided with the Colittos because the key condition, the key issue in this case was in fact the timing. When was Mr. Colitto in fact the debtor? And the Tax Court of Canada concluded that Mr. Colitto was a debtor when the Sherriff was unable to execute the writ in 2011. And as I mentioned before, Mr. Colitto transferred the houses in 2008.

The CRA appealed to Federal Court of Appeal, and the Federal Court of Appeal overturned the Tax Court of Canada's decision and concluded that it would defeat the purposes of the Income Tax Act if there was a significant time gap between a corporation's default and the director becoming personally liable.

You can imagine the planning that would be undertaken in such a situation that frustrated the CRA, just like what Mr. Colitto tried to do. Instead, the Federal Court of Appeal concluded that Mr. Colitto's liability began immediately after the corporation defaulted on the source deductions in early 2008, and upheld the assessment against Mr. Colitto accordingly. This case clarifies that directors are liable immediately after a corporate default, limiting the creditor-proofing steps that they can take.

This is a very important case, particularly in the midst of the current health and economic crisis that we're undergoing, and this is more bad news for business owners. Permitted government delays to GST and HST remittances and tax returns almost implies to business owners that they can use these funds to keep their business afloat. For example, using these funds to pay other creditors like a supplier instead of remitting these funds to the government. But this case is a clear warning that GST/HST remittances and source deductions may not be used by the corporation or the director without some serious personal liability consequences later.

So clients should seriously think about choice. Seriously think twice about using these funds for other purposes. This is a great example of where an advisor can identify issues and protect the client from making a terrible mistake. Obviously, part of the solution is directing the client to their tax and legal advisor in such situations also.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

John, that's a very interesting case and a good eye-opener for directors about their potential personal exposure. I think you mentioned another case with different facts but a similar conclusion that is important for directors to be aware of. Can you share that with us?

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Yeah, absolutely. This case involved the Volovics, a husband and wife. They were the directors, shareholders, employees of an electrical business that in 1995 failed to pay their taxes and there was a significant tax liability with interest and penalties that that was accruing. And in the years following 1995, the Volovics received compensation in the mix of salary and dividends, the amount varied year-by-year based on the tax advice of their accountant. The CRA assessed the couple jointly and severally liable based on the dividends received under the same provision under section 160 that was raised in the Colitto case. And if we go back to section 160, again, think about the criteria that's required there.

So, there must be a transfer of an asset by a debtor at the time. In this example, the corporation is the debtor, so it was definitely a debt at the time of the payment of dividends. And there must be a transfer in assets to a related party. Well, the Volovics were the sole shareholders, they were the related party. And the transfer for it must be for less than the fair market value. And the CRAs position was that the dividends were given without any consideration back.

Now, the Volovics argued that the dividends represented compensation for their labour and therefore that was sufficient consideration. The court agreed with the CRA and cited some Supreme Court of Canada decisions which ruled a dividend is related to being a shareholder only and not to any other consideration such as any contribution to a company in terms of labour. The dividends received and the quantum of the dividends received are mutually independent of one another. So, the Volovics were personally liable for the tax debts of the corporation up to the amount of the dividends they received.

Note – and this is a very important point – it is generally accepted that reasonable salary paid is not considered a transfer and not subject to such a claim under section 160 by the CRA. So if the Volovics had in fact paid themselves only salary in those years, the CRA might not have had any recourse against them personally.

So, for those business owners facing a traditional debate whether to pay themselves salary or dividend, this may be a factor now that changes their decision or conclusion.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Wow! Those cases definitely open your eyes to the potential landmines that people may not be aware of and definitely reinforce the value of good advice. Any other thoughts for companies in distress, John?

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Yeah. One more quick one, if I may. If your company is in distress and you have a balance in your capital dividend account, also called your CDA, think about paying out a tax-free capital dividend, which is what the CDA allows you to do, and then potentially lending it back to the corporation if necessary if the corporation needs the funds. This way you don't lose the tax-free payment option since you can always pay back a shareholder loan tax-free and you can still provide liquidity to your corporation if it's needed.

Also, since these funds are now a debt of the corporation as per the shareholder loan, you can try to give yourself priority in terms of repayment of those funds in case you need to, for example, if the corporation is being wound up.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Thanks, John. Let's go to Dave to see his thoughts on options for companies that have been positively impacted by COVID.

Dave Turnbull, Head of Private Company Advisory, Manulife Securities

Yeah, if you're a business owner that's been positively affected by COVID, and there are quite a few, consider both organic growth and growth by acquisition. For organic growth strategies, one of the issues you might ask is: Do you have enough capital to accelerate your growth? Make sure you're spending to ultimately earn a return in excess of your cost of capital. So, for example, if you're borrowing money at 5%, you want to earn a return of something greater than that, like a return on equity of 25%.

Another consideration is do you have the right sources of capital? There's a lot of liquidity looking for good businesses and interest rates are at record lows. While the banks support low risk, low cost lending, there are many other sources of capital, including asset-based lenders, subordinated debt and mezzanine lenders, venture capital and private equity. Private Company Advisory connects businesses with hundreds of thousands of sources of capital in Canada and the United States. We want to help people, or help business owners, obtain money.

Another way to grow is by acquisition. By combining businesses, synergies can be created by merging two businesses and often creates wealth for business owners. The concept here is one plus one equals three. Let me give you a couple of examples. First, cross-selling. Let's suppose you have a business that produces orange juice, and you want to buy a business that produces apple juice. After paying fair value for the apple juice company, you increase value by cross-selling. Sell orange juice to the apple juice customers and vice-versa. That's just one example.

Another might be combining businesses to decrease competition and get an increase in profitability. We're currently working with a company that provides commercial services to a specialized market. There are three competitors who send sales people out to bid on jobs and they are constantly trying to out-bid each other on price, which ultimately squeezes everyone's margins. We can roll these three companies together, prices go up, margins go up and costs drop by eliminating redundant overhead, getting better supplier terms and obtaining operational efficiencies.

A final example would be combining technology with distribution. For example, take an upstart technology company who can develop better, faster and cheaper than large companies, but need the benefit of a brand and distribution of, say, a large global company. The challenge is for that small company in getting it out to market organically and competing with the large is extremely difficult and it's a long-term plan.

So instead, take the large company who benefits from the technology, leverage the brand and distribution and you grow the company much quicker. And at the same time, you might reduce redundant overhead, expand products and markets and improve the customer experience.

There's a lot of capital to support these purchases at valuations that are generally lower than pre-COVID, so I'd keep that in mind.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Thanks, Dave. John?

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Yeah. For successful companies, there are different but equally important considerations. Often business owners build up significant retained earnings or after-tax profits within their corporation and rather than withdrawing those funds and incurring significant taxes and investing those reduced amounts personally, they are being retained in the corporation and invested in the corporation until needed.

Now, since corporate tac rates and investment income, which is also called passive income, are very high – in fact they are very similar to the top marginal tax rates for individuals – it's important to invest corporate dollars in tax-efficient investment vehicles.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

So, John, tax-efficient investing with your corporate funds is important due to the high tax rates. I'm sure many of our clients can relate to that. Are there any other reasons why tax-efficient investing is important for corporations?

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Yes, there are. Corporations enjoy a preferential tax rate of approximately 12%, depending on the province that you're in, on the first half a million dollars of active business income, which is also knows and a small business deduction. Now, active business income is differentiated from passive or investment income. Example of an active business income is for example legal fees for a lawyer, medical fees for a doctor, or net income from sales to our store, our manufacturer or our supplier.

Now, as a result of a few tax changes of a few years ago, if a corporation's annual passive or investment income is $50,000 or more, its small business deduction limit – again, the amount of active business income that is eligible for that low tax rate of approximately 12% -- is gradually reduced from half a million dollars and eventually completely eliminated when the corporation's passive income reaches $150,000.

The way this works is that for every dollar of passive income above $50,000, the small business deduction limit of half a million dollars is reduced by $5.00 or by a factor of five. This effectively increases the amount of tax a corporation would pay on its first half a million dollars of active business income from approximately 12% to

12%, again depending on your province. This can result in the corporation paying significantly more tax up front.

Now, if earning too much investment income in your corporation is an issue for you and you're concerned about the potential reduction of the small business deduction in it, there are strategies available that can help. You can try reducing the amount of passive income your corporation earns by focussing on tax-efficient investment options, which also include life insurance, so don't forget that.

Also, if you can tax-efficiently distribute some of the retained earnings out of the corporation so it has less to invest, this can also reduce the amount of passive income the corporation has earned. Examples include repaying shareholder loans, because those are tax-free, and as well as paying dividends out of the capital dividend account like I mentioned earlier. Again, this reduces the amount of assets in your corporation to invest and reduces your passive income.

Realizing capital losses can also be used to offset capital gains in the year and reduce passive income. However – and a big red flag here – be very, very careful about realizing capital losses because when you realize a capital loss, it also reduces your capital dividends account, which is, again, the amount that the corporation can pay out tax-free as a capital dividend. So, before you realize a capital loss, I strongly encourage clients to speak their tax advisor to make sure that everything's on board and it makes sense. And if there's a balance in your capital dividend account, you pay it out before you realize the capital loss.

On the other hand, you could try to reduce your active business income by maximizing expenses such as paying compensation in the form of salary instead of dividends, like in the Volovics case, provide a salary that's reasonable, and claiming deductions where eligible, such as interest and investment counsel fees like Manulife Private Wealth's Investment Counsel fees, as well as making employer contributions to certain plans like RSPs, IPPs and RCAs.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Finally, Dave, John, what are you guys thinking about in terms of the impact on a business exit?

Dave Turnbull, Head of Private Company Advisory, Manulife Securities

I regularly speak to owners and managers who may be considering a sale of their business. While the market fell sharply with the onset of COVID, it's rebounded to reasonable valuations. As I mentioned earlier, there's a lot of liquidity and interest rates are at record lows, which means buyers are looking for both good companies and distressed deals.

We broadly classify buyers into two types: strategic buyers which mean competitors, and financial buyers like private equity funds. Depending on the type of business, one group may outbid the other. We typically include both types in our auction process in order to maximize value. Management successors could be potential buyers as well, although they typically finance their way into ownership and the exit price and terms are not typically as attractive as third-party bids.

Where there's a gab between the bid and the ask, a good deal structure can help close the gap and get the deal closed. It doesn't have to be an all or none outcome either. Consider taking some chips off the table by either leveraging up your business to a prudent level, or by bringing in a private equity partner. This might give you a partial exit and create some third-party accountability to the ultimate management successor.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

John?

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Yeah. For those individuals considering an exit, proper tax planning can also make a big difference. I'll use the lifetime capital gains exemption as an example. If you're selling the shares of your corporation, which is usually preferable from a seller's perspective as opposed to selling the corporation's assets, you want to ensure you take advantage of the lifetime capital gains exemption, assuming you qualify. This allows you to avoid paying tax and up to approximately $880,000 of capital gains.

Now, in order to be eligible for the lifetime capital gains exemption, there are several tests that must be met with respect to the types of assets owned by the corporation and the length or period during which the shares are held. As part of these qualifying tests, it is important to keep a careful eye on the amount of investments held inside the corporation. And if too large an amount of investments is held inside the corporation, it is possible that the corporation would be tainted for purposes of the exemption, and you won't be eligible.

However, if you offside, there may be ways to correct this, and this is often referred to as purification strategies. So not all hope is lost. At the end of the day, these are very complex rules, so it's critical that a tax profession be brought in to assist you with this type of planning.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Leslie, as a Family Enterprise Advisor I know you have some thoughts to share on business exits and transition. Given Dave's and John's comments, where are you at this?

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

Well, Glen, beyond the financial and tax considerations that Dave and John just referred to, there are some key non-financial considerations for business owners when considering an exit. If you think about the inter-relationship amongst the business, the owners and the family, a business exit can have a huge impact on how the family identifies itself in the community. And, if other family members are also shareholders but do not work in the business and are not yet sophisticated from a financial perspective, the liquidity windfall may catch them unawares. Of course, MPW is always there and available to help where excess liquidity is an issue or where the large dollar values available for investment that could stress out the advisors.

Beyond family considerations, business owners worry a lot about the downstream effects an exit of the business will have on long-standing employees. What does continuity look like for them? How will these employees work with their new owners?

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

What about governance structures? I've heard there's different types of governance structure which can help business owners.

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

You know, Glen, it's surprising for people to learn how helpful governance structure are to the overall business, and they don't always have to be that formal, just functional. I like to recommend starting by developing a family constitution and professionalizing the ownership group through education and experience. These are great steps to ensure the long-term functioning nature of the ownership group and the business. Of course, governance structure also goes a long way to identifying who and what types of decisions individuals in the ownership group can make. This can be really helpful when decision have to be made really quickly.

The intensity of the economic stressors we've all been going through during COVID are no doubt playing on the long-term vision of certain business owners. Decisions have had to be made on the fly and many more decisions are still being made as owners navigate this new normal. It's been a really tough time on small business owners who may have felt very much alone steering the course of their business during these unpredictable times.

Considering the panel assembled here today, it's evident Manulife Private Wealth is here to help.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

That's why I'm really excited to be a part of this conversation. There are some great ideas here to help business owners think about some of their next steps. I'm curious, Dave, from a mergers and acquisitions perspective, what activity are you seeing?

Dave Turnbull, Head of Private Company Advisory, Manulife Securities

Well, prior to COVID, we were working on selling businesses as valuations were quite high. With the onset of COVID, these initiatives were put on hold as market prices dropped. During COVID, we've been working on restructuring balance sheets in order to ensure that our clients have enough capital to allow them to grow and take advantage of COVID-accelerated opportunities.

Some clients who have liquidity or can get liquidity by leveraging their balance sheets, are in a great position to go shopping for some deals like buying distressed businesses or even investing in marketable securities.

Leslie, I know this is one of the key advantages of working with your investment counsellors at Manulife Private Wealth, perhaps you can comment on that shortly.

As we go through – or as we progress through COVID, we've seen a recovery in business valuations, so some of the divestitures that we put on hold early on are now back in process. We feel that the right buyer will still pay top dollar, but there may be some work to determine the right deal structure to close a potential bid ask gap due to the future uncertainties of the business. Upon closing the transaction, we like to work with our clients to ensure they minimize taxes and maximize risk-adjusted investment returns.

Again, Leslie, this is where I know your group is very different and adds tremendous value.

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

Thanks, Dave. Yes, MPW recently worked with a family who sold their business while we were all in shelter at home mode. As you can imagine, there were some really stressful moments for the family leading up to the signing of the sale agreement. Happily, the family sealed the deal on what they considered fair terms and are now actively embarking on their next venture. MPW was successful winning the investment mandate for the family's corporate account based on our investment processes and our ability to provide investment exposure to public markets as well as private market investments such as real estate, infrastructure and other real assets.

The family have expressed confidence in MPW, our processes and the dedicated support we receive from the Manulife teams who consult on the billions of dollars Manulife manages for its own balance sheet. They also really liked the role of the independent advisor who will continue working with them to develop and evolve their planning needs for the next phase of their lives.

Throughout the lockdown, I know my team was working with advisors on a number of MNA deals that were sidelined due to COVID. However, in these last few months we are seeing business flows into MPW picking up tremendously. Notwithstanding the truly outstanding team I work with, I know it's also because MPW has pivoted towards a more digital experience with advisors and clients, incorporating video conferencing technology either via Zoom or Microsoft Teams, and has successfully transitioned our account opening processes to digital via DocuSign. I guess you could say we too have become more agile.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Let's go deeper into business transitions. I know business transitions are complicated and not always as successful as expected.

Dave Turnbull, Head of Private Company Advisory, Manulife Securities

I agree that business transitions are complicated and can be very challenging. However, our success tends to exceed expectations. Closing a successful deal is not a secret. It begins with talented professionals, combined with access to an enormous amount of data on businesses and industries, and ends with a ton of hard work over at least six months. If you know of a business that may be transitioning to a strategic or financial buyer or to the next generation of managers, this transition needs to be handled properly and requires careful planning, often beginning many years prior to the ultimate transaction.

We're working with a business now that will have several consecutive transactions prior to their ultimate exit. First, we're closing a debt financing at the end of this month that will lower borrowing costs. Next, running concurrently, we're raising equity from a venture capital and private equity investors that have strategic relationships. And by that I'm referring to investors with relationships to potential buyers.

For example, in this case we're going to groups like Rogers Ventures, Comcast Ventures, G Ventures, which is Google, and other venture capital companies that have money from potential buyers in their fund.

We look at the funding process and business development for the company as a multi-step strategic process where customers and investors will ultimately become buyers in an auction process. It positions the company favourably for a really good exit that will likely happen in this case in about two years.

We did this with another business recently as well. The seller had a great product, but needed the benefit of a global brand and distribution to get to market quickly. The large global companies needed a new product. We ran a sale process, but there was a gap between the bid and the ask, or the purchase and selling price. Instead, we negotiated non-exclusive distribution agreements with all the potential buyers, which will likely result it at least one group wanting to buy the product. The response from the others on that initial bid will be to create an auction or risk losing access to the product. This is how we embed the auction process into the whole planning process, the strategic planning process.

So, if you know of any business owners where their exit is more imminent, some things that we look for are as follows. Successors within management, reduction of business risk such as reliance on key people. We want to see diversification among customers, products and distribution channels, and perhaps hedging strategies for foreign exchange and commodity price adjustments. Also, it's good to have proper accounting systems and reporting and up-to-date contracts and minute books.

Now only is preparation leading up to the transaction important, but post-closing transition can have a devastating effect if the seller is ill prepared. Selling your business is a big deal. Your business is pat of identity and represents a tremendous amount of hard work, inevitably filled with highs and lows over time. A small army of people called employees respond and implement your vision and mission. Selling your business can create some powerful emotions. In this transition, it's important to develop a new raison d'être, including new or different relationships or even new hobbies and passions.

We recommend a transition period which is jointly determined by the buyer and seller. The business owner's new role could be an active day-to-day role or a passive role, say, on the board and everything in between. Selling your business is a process and we recommend starting right away. The ultimate goal-setting exercise is to craft your exit the way you want. We want you to reach out to Private Company Advisory to discuss opportunities to service high-net-worth business owners, and we're part of the services available to you, the advisor, to help your clients and prospects.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Leslie, do you have any comments about that?

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

Absolutely. And I echo Dave's comments. Transition plans are fundamental to the ongoing success of any family-owned business, and it's never too late to start thinking about them. I think COVID has helped highlight the importance of resilience in the face of uncertainty. To survive, just think of how many businesses pushed hard in a very short time to adapt their processes and business models despite the challenging conditions.

I was reading an article the other day published by the Family Enterprise Foundation, which suggested an all-hands-on-deck approach to managing through this crisis, which I think could equally be applied to business transitions. It speaks to leveraging the fresh ideas and untapped energy of the next generation while at the same time relying on the older generation's longstanding relationships to rebuild or emphasize the trust that has long existed with clients, bankers, employees and suppliers.

Transition plans are all about continuity and ensuring the ongoing success of the business once the founder has moved on. Ideally, they deal with multiple moments in the lifetime of the business, like tremendous growth in sales, strategic acquisitions, as well as unforeseen crises like illness of a key member of the business or a steep drop in revenue.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

So, is transition a bad thing?

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

Not necessarily. Transition planning can lead business owners in different directions. For example, there may be a new project <inaudible 00:38:31> the relinquishing partner finds more inspiring than what they're leaving behind, or the future might mean spending more time with family and leaving the hustle behind.

Whichever the direction, usually there's a financial incentive involved which can be quite sizeable. In fact, sometimes the dollar signs are so large that in the last few years, we've seen families look to charitable giving as a way to give back to the community which has supported their business for so many years.

John, I know you have some thoughts from a tax perspective that you can share with us today on the topic of philanthropy.

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

Yes, I do. There's a really clever corporation donation strategy for those who are charitably inclined and have investments within their corporation that have grown in value and represent unrealized capital gains. It involved donating these corporate investments in kind to a charity. This might be particularly timely, as I hear that many charities are currently struggling. Furthermore, if the government increases the capital gains inclusion rate like many suspect they will, the tax savings generated with this strategy will be even greater.

So, what are the advantages of such a strategy? Well, donating an investment in kind – so the key here is a donation in kind as opposed to selling the investment and donating the cash – donating an investment in kind to a charity provides the following three benefits to the corporation and shareholder in addition to hopefully increase the amount of the charitable donations.

Number one: The corporation can claim a deduction equal to the fair market value of the investment donated, generating tax savings. As individuals, when we donate to a charity, we get a tax credit. When corporations donate, they get a deduction. Either way, it reduces the tax payable. Now, this also reduces the amount of passive investments the corporation has going forward to help reduce the income a corporation reports and potentially avoid a reduction in small business deductions, which I had mentioned earlier.

Number two: The gift of the investment to the charity is considered a disposition. However, the capital gain on an in-kind gift is reduced to zero, just like when you and I donate personal investments to a charity in kind. There's no tax payable from the disposition resulting on the in-kind donation, but resulting in significant tax savings as compared to the taxable capital gain the corporation will realize when it eventually disposes of the investment in the future.

And thirdly, finally, an additional benefit with an in-kind contribution or donation to a charity is that 100% of the capital gain is added to the capital dividend counter CDA instead of the normal 50% with a regular capital gain. This results in additional tax savings, because the higher the amount in the CDA, means more money can be distributed to a shareholder tax-free as a capital dividend.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

That's great, John. Another way is to set up and meet the family's philanthropicals (sic), it might be to set up a donor advice fund either through charity or through a charitable foundation such as Canada Gives. There are several benefits to either approach, which are beyond the scope of this conversation today. But if you wish to discuss more about donor advice funds, don't hesitate to reach out to a team member at MPW.

We are seeing lately some very significant gifts being made by very wealthy families consistent with their long-held values. Recently, the James and Louise Temerty Foundation announced a gift of $250 million to the University of Toronto to fund a new centre for artificial intelligence and healthcare, provide support for underrepresented students and money to attract research talent. And last year, John and Marcy McCall MacBain announced a $200 million gift to fund a scholarship program at McGill University.

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

That's a great deal of money for the university to spend and a huge gift for U of T when you consider their endowment fund was at $2.5 billion, and for McGill, where their endowment fund is at $1.7 billion.

You know, wealthy families are increasingly deciding to leave a significant portion of their wealth to charities for very specific causes. And in doing so, set up the foundations you just referred to. These foundations help promote a sense of responsibility to the community across successive generations.

John Natale, Head of Tax, Retirement & Estate Planning Services, Manulife Investment Management

This made me think of a quote from Warren Buffet when they asked him how much is the right amount to leave the kids so they don't suffer from what we call "affluenza?" His response was, "The perfect amount to leave to children is enough money so that they would feel they could do anything, but not so much that they could do nothing." I figure ending with a quote from the Oracle of Omaha is somehow fitting.

Leslie Brophy, AVP, Head of Investments and Sales, Manulife Private Wealth

John, you know, even at more modest levels of wealth, families find philanthropy is a great way for members of the family who are not directly involved in the family business to contribute to the family's legacy. It helps bring the family together around a common goal, their legacy, if you will, and instills a sense of responsibility across all generations for preserving and growing the wealth, not to mention building personal financial literacy.

I understand more and more advisors are being asked about philanthropy and how to incorporate charitable giving into their customer's financial plans. These discussions are a great way to connect with the whole family, including the kids, and go a long way to deepen the relationship advisors have with their families and their clients.

One caveat though, I would approach the discussion in a way that is respectful of client values and privacy. It's really those clients who view their advisor as a trusted professional who will be more open to having the philanthropy discussion.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Thanks, Leslie. I think that's all the time we have for today. As mentioned earlier in the call, this conversation has been recorded and will be available upon request. We hope today's comments on strategies regarding ownership, business transitions and philanthropy were helpful to you as you look to the last part of 2020. As always, if you're curious to find more about what Manulife Private Wealth's investment platform can do for you and your clients, don't hesitate to reach out to a member of the team.

We look forward to hosting our next regular call in December 2020. Thank you everyone, this concludes the call for today.

Follow the Private Wealth Podcast on www.manulifeprivatewealth.com or contact us via manulifeprivatwealth@manulife.com for more information.

A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange trading suspensions and closures, and affect fund performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future, could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other pre-existing political, social and economic risks. Any such impact could adversely affect fund performance, resulting in losses to your investment.

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