

CROSS PRACTICE PLANNING FOR BUSINESS OWNERS

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Agenda

- Wills, Powers of Attorney, Probate Planning
- A Note on Professional Practices
- Estate Administration – some considerations
- Corporate life insurance – tax risks and traps
- POAs and corporate association
- ABIL Claims
- Corporate Governance Planning for Death & Disability
- Key provisions in a Shareholder Agreement

Wills, Powers of Attorney, Probate Planning

- Why have a Will?
- Probate Planning - Multiple Wills
- Powers of Attorney

Why have a Will?

- Choice of beneficiaries and distributions
- Ability to address complex family and asset structures
- Choice of executors
- Executor powers to administer corporate interests in the estate
- If multiple Wills (see below) – probate planning opportunities

Why have a Will?

- If no Will
 - statutory intestacy rules - pre-determined distributions to certain individuals under the *Succession Law Reform Act*
 - no choice of executor – order of who can apply under s. 29 of the *Estates Act*
 - Limited executor powers

What is Probate?

- Certificate of Appointment of Estate Trustee (“**CAET**”) – commonly referred to as “**probate**”
- Over-the-counter court application
- Third party requirement

Estate Administration Tax

- When executors apply for a CAET, they have to pay estate administration tax (“**EAT**”)
- Rate is 1.5% of the value of assets over \$50,000 passing through the Will – so approximately \$15,000 of EAT payable on every \$1,000,000 of estate value

Does an Asset Need Probate to be Transferred?

- Bank accounts/non-registered investments, Ontario real estate in the person's sole name usually need probate
 - “Tenants in common”
 - Assets outside Ontario – check requirements in other jurisdiction
- Registered accounts (e.g., RRSPs, TFSAs), life insurance – check designations

Does an Asset Need Probate to be Transferred?

- Private corporation shares – usually probate not needed
 - Mainly talking about Ontario corporations here – get advice from lawyers in other jurisdictions re probate requirement for corporations in other jurisdictions
 - Review shareholder agreement
- Other types of assets that usually don't need probate – personal effects, bare trusts, “first dealing” real estate

CAVEAT

- If a person had only one Will and even one asset in the estate needs probate or the person had no Will – **All* assets forming part of the estate will be subject to EAT**
- *not real estate outside Ontario
- **IMPORTANCE OF PLANNING**

Probate Planning Using Multiple Wills

- Commonly used strategy where private corporation interests of a certain value
 - Will 1 – deals with assets that require probate (Primary Will)
 - Submitted for probate
 - Will 2 – deals with assets that do not require probate (Secondary Will)
 - Not submitted for probate

Multiple Wills

- Factors that may interfere
 - Changes to applicable laws
 - Changes to administrative practices of third parties
 - Will challenges
 - Cost and complexity of set up may be deterrent
 - Check shareholder agreement

Powers of Attorney

- A Power of Attorney is a document that appoints a person (the “attorney”) to make certain kinds of decisions on behalf of the person giving the power of attorney (the “grantor”).
- POAs for Property and Personal Care
- As important as having a Will
 - Incapacity planning – a Will only governs what will happen on death

Powers of Attorney for Property

- Continuing Power of Attorney for Property (“**CPAP**”)
 - CPAP for corporate assets
 - CPAP for personal assets
- Review Shareholder Agreement
- Consider corporate association rules (Avery will discuss in further detail)

Professional Practices

- Check rules of governing bodies to determine what steps should be taken in the estate with respect to a professional practice.
 - Often limits on who can administer the professional practice - e.g., only another member of the profession
- Importance of having a plan in place beforehand.
- Professional Corporations in estate – steps to continue as a standard business corporation, which involves changing the corporation name and the scope of its activities.

Estate Administration – Some Considerations

- Importance of planning during lifetime
- Deemed disposition on death
 - Consider potential tax liability in estate and plan for same – e.g., consider corporate life insurance
- How will corporate interests be administered in the estate?
 - Are there shareholder agreements in place?
 - Postmortem planning – talk to accountant or tax lawyer
 - Importance of executor powers
- Business continuation
 - During estate administration
 - After estate administration

Corporate Tax - Agenda

- Corporate life insurance – tax risks and traps
- POAs and corporate association
- ABIL Claims
- Key takeaways

Why this matters

- Business owners have far more risk
- Multiple entities, shareholder loans, retained earnings, insurance, succession, all interacting
- Planning failures have real dollar consequences
- Accountants often are the first to see the full picture

Corporate life insurance - Overview

- Premiums are paid with corporate dollars
- Death benefit adds to Capital Dividend Account, flows to estate tax-free
- Often structured incorrectly and only identified at death

Corporate Life Insurance – Traps

- Trap 1 – Wrong entity
 - Holdco holds policy / Opco named in shareholders agreement or will
 - CDA credit arises in the wrong entity
 - Extracting value across entities post-death is costly or impossible

Corporate Life Insurance – Traps

- Trap 2 – Unverified assumption
 - Clients routinely assume the full benefit is tax free
 - Death benefit = CDA minus ACB
 - Newer policies don't benefit from full benefit

Corporate Life Insurance – Traps

- Trap 3 – Pipeline sequencing
 - Pipeline strategy: extract retained earnings at capital gains rates versus dividend
 - CDA election and pipeline steps must be sequenced correctly
 - A sequencing error can be expensive and sometimes irreversible

Corporate Life Insurance – Checklist

- Which entity holds the policy?
- Has anyone reviewed the current policy details and ACB?
- Has anyone modeled how the CDA interacts with the estate plan?
- Are the tax lawyer and estate lawyer coordinating with each other

POAs For Business Owners - Risks

- POA for property activates -> attorney steps into client's shoes as shareholder
- Misalignment with corporate governance
- Lack of safeguards or oversight
- Incapacity planning gaps

POAs For Business Owners – Association

- ITA states two corps are associated if same person control both (or related persons)
- Association means they have a shared SBD limit instead of two full limits

POAs For Business Owners – Association Trap

- Attorney named under POA may technically “control” client’s shares
- If attorney also controls another corporation
-> unintended association
- CRA’s position on attorney-as-controller is not consistently favourable
- Cannot simply assume its clean

POAs For Business Owners – Association Trap Fix

- PRIOR to incapacity
 - Choose attorney carefully, avoid competing corporate interests
 - Consider corporate attorney-in-fact rather than individual
 - Draft POA with specific carve-outs around share voting
 - Requires coordination between lawyer and accountant

POAs For Business Owners – Association Trap – Accountant's role

- Be aware of the client's corporate structure
- When POA is being updated, ask whether the named attorney has corporate interests
- If yes, flag it before the document is signed

Allowable Business Investments Loss (ABIL) - Overview

- Loss on shares or debt of a Small Business Corporation (SBC)
- Unlike a capital loss, deductible against all sources of income
- 50% inclusion rate
 - Ex: \$200,000.00 eligible bad shareholder loan results in \$100,000.00 deduction against all income
- Significant relief that may be overlooked

ABIL Traps – SBC Status

- Corporation must qualify as SBC at **time loss is recognized**
 - Requirements = CCPC plus all or substantially all assets used in active Canadian business
- What can interfere with SBC status:
 - Passive investments or excess cash holdings
 - Intercorporate loans
 - Shift in control
- Never assume, must verify

ABIL Traps – Section 50(1) Election

- Required to crystallize loss on bad debt or worthless shares without actual disposition
- **Must be filed in the correct taxation year**
 - Year the debt became bad shares became worthless
- CRA position: not discretionary – miss the year, lose the election
- Not always straightforward determining the date a debt actually went “bad”, but its crucial

ABIL Traps – Estate and Terminal Return

- Shareholder dies holding worthless loan to own corporation
- No section 50(1) election filed during lifetime
- Estate now arguing the point after the fact on terminal return
- An avoidable ABIL dispute compounds already difficult administration

ABIL Traps – Questions to ask

- When a client's private company is struggling or has been wound down:
 - Were shareholder loans made to the company?
 - When did those loans actually go bad, and is it documented?
 - Was a section 50(1) election filed in the correct year?
 - Does the corporation still qualify as an SBC?

The common thread for these traps

- Corporate life insurance, POA's, shareholder loans, they exist on almost every business owner file
- They get missed because advisors are siloed
- Accountants usually have the most complete financial picture

Three final questions to ask clients

- Who holds the corporate life insurance, and has anyone actually reviewed the policy recently?
- Does the POA attorney have corporate interests that could trigger association
- Has anyone looked at an ABIL claim, and was the section 50(1) election filed in the right year?

Corporate Governance and Planning for Death & Disability

- Differences between shareholders and directors
- What happens when a shareholder dies?
- What happens when director dies?
- Next steps are dictated by whether a shareholder agreement is in place for this corporation

What is a Shareholder Agreement?

- Contract between some or all of the shareholders (and often the corporation itself)
- Designed to outline rights and obligations of the shareholders
- Addresses governance, operations, decision making authority, restrictions on the transfer of shares, dispute resolution mechanisms, and procedures for the admission or withdrawal of shareholders
- Specific provisions set out what happens on death/disability/incapacity of a shareholder

Shareholder Agreement Provisions re: Death

- Four common scenarios:
 - 1. Corporation (and/or the remaining Shareholders, as they may agree) obliged to purchase shares of deceased on death
 - 2. Option of surviving shareholders to purchase shares of deceased on death
 - 3. Option of estate to require surviving shareholders (or Corporation) to purchase shares of deceased on death
 - 4. Shares of deceased may be transferred to the estate and to the beneficiaries thereof

Mandatory Buy-Out

- Most common approach
- Surviving shareholders don't want to be in business with the estate and/or beneficiaries
- Beneficiaries want cash
- Funding by life insurance a possibility

Shareholder Option to Buy Shares

- Often called a “call” option
- Allows flexibility for surviving shareholders if funding the purchase will be a problem
- However, if operational or governance challenges present while dealing with estate of deceased, surviving shareholder group has option ready to exercise
- Deceased’s estate may benefit from continued growth of the business (or negative downturn)

Estate Option to Require Shareholders to Buy Shares

- Often called a “put” option
- Estate trustee has flexibility to decide whether cash is needed to settle estate debts or pay taxes
- Estate may benefit from future dividends declared
- Again, estate may benefit from continued growth of the business (or negative downturn)
- Not often used in practice because it creates uncertainty for surviving shareholders

Shares of Deceased are Transferred to Estate

- Transfer of deceased shares from deceased to estate and from estate to beneficiaries a “permitted transfer”
- The surviving shareholders have no special right to acquire the shares, and the estate has no special right to force a sale
- Can cause governance problems and uncertainty for all parties
- Risk of deadlock in the future

Closing of the Purchase

The shareholder agreement should stipulate:

- Valuation method - how the shares will be valued at the time of death (formula-based, independent appraisal, or agreed-upon fixed price)
- Purchase price payment - lump sum at closing, installments over time, or a combination
- Timeline - how quickly the buy out must be completed after death (typically within 60 to 180 days)

Disability

- Disability should be clearly defined within the shareholder agreement
 - Preferably determined by a physician
- Are the shareholders required to devote their full time and attention to the business?
 - If no, status quo can continue – disabled shareholder holds on to their shares, POA for property can vote on their behalf (if applicable)
 - If yes, there are various buy out scenarios

Similar Buy Out Options:

- Mandatory buy out by remaining shareholders or Corporation
- Option to buy out by remaining shareholders or Corporation
- Option for disabled shareholder to require buy out by remaining shareholders or Corporation

QUESTIONS?

Wilson Vukelich LLP can help ensure that your matters are handled effectively and efficiently, and in manner that is reflective of new legal developments and obligations. If you have any questions or require further information, please contact:

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