



LAPOINTE ROSENSTEIN  
MARCHAND MELANÇON

L.L.P. Attorneys

# Newsletter

## Tax, Estate Planning and Tax Litigation

February 2016



*M<sup>re</sup> Catherine Tremblay, M. Tax  
Notary*

### What happens after your funeral is a priority!

Newspapers, social networks, courses and coaching sessions, to name but a few, constantly stress the importance of drawing up a will. Yet, every day we come across entrepreneurs, men or women, who like some of you have not taken the time to prepare or update their will. So, if the transfer of your estate to your heirs is a major headache, imagine what the transfer of your business after your death could represent if it is not carefully planned.

I present here the story of Ms. Francoeur and Mr. L'Amoureux, inspired by actual cases that you might relate to. There are countless similar stories! This is a highly technical issue that involves inheritance rights, corporate laws and tax laws. The goal is not to overwhelm you with complex rules, but to present you with some cases involving the transfer of shares of a SME upon a death and to highlight the problems that can result from poor estate planning.

#### **Mr. L'Amoureux and Ms. Francoeur: common law spouses and shareholders**

Mr. L'Amoureux has lived with Ms. Francoeur for nearly 20 years. Ms. Francoeur is 55 years old and Mr. L'Amoureux 45. They have no children together. Mr. L'Amoureux has two children from a previous marriage, aged 30 and 35.

Ms. Francoeur is the sole shareholder of Healthco, a natural products company that develops and sells its own products and owns several buildings that are used for the

manufacture and distribution of such products. Mr. L'Amoureux works for a government agency. Ms. Francoeur's tax accountant, Mr. Smart, informed her that to reduce her operating risks and, in addition, optimize her taxation, she could incorporate another company in which Mr. L'Amoureux would be sole shareholder ("Immoco"). Ms. Francoeur subsequently restructures her company such that her husband, in whom she has full confidence, becomes the sole shareholder of Immoco to which the properties are transferred. The Immoco buildings are leased to Healthco, whose sole shareholder is Ms. Francoeur. Without commenting on the weaknesses and tax pitfalls that this structure presents, let's look instead at what would happen if tomorrow morning Mr. L'Amoureux dies without a will.

The Quebec Civil Code states that upon his death, in the absence of a surviving "married" spouse, all his assets, including shares of Immoco, will vest fully to his children. So Ms. Francoeur could be forced to "buy" the shares or assets of Immoco in order to continue its business activities, even though the couple in no way intended to leave such valuable assets of the surviving Ms. Francoeur to Mr. L'Amoureux's children.

#### **Mr. Badlucky, a new partner of... the estate of Ms. Francoeur!**

Ms. Francoeur and Mr. L'Amoureux have always been a team in their life as a couple. It was always Ms. Francoeur's intention to ensure that Mr. L'Amoureux's dedication to the family organization be recognized and that his standard of living be maintained upon her death. She therefore intends to bequeath the entire value of Healthco to him. When integrating a new shareholder in Healthco, Mr. Badlucky, she therefore ensures that a shareholder agreement is drawn up so that Mr. Badlucky can, upon the death of Ms. Francoeur, buy the shares from the estate of Ms. Francoeur and ensure that her partner, Mr. L'Amoureux, receives a fair price. Healthco also purchased life insurance for each partner to ensure the financing of this acquisition.

Trusting Mr. Smart, Ms. Francoeur and Mr. Badlucky then quickly consult him to learn about the tax implications of the death of either partner. Mr. Smart reminds them of the importance of proceeding with the vesting of the shares to

the spouse to avoid any tax impact upon death. Mr. Smart is reassured to see that a shareholders' agreement has been signed. So they go to notary Finicky to sign their wills. Notary Finicky provides for a particular legacy of the Healthco shares in favour of the surviving spouse. Here are the implications of this estate planning in the event of the death of Ms. Francoeur or Mr. Badlucky:

The estate liquidator has an obligation to deliver the assets to the legatee by particular title and may not sell them unless the other assets are insufficient to pay the debts of the deceased. He therefore may not sell the shares to the surviving shareholder as stipulated in the shareholders' agreement and must return the shares to the legatee by particular title in accordance with the will. Moreover, the legatee by particular title, unlike the so-called heir of residual assets, is not required to settle the debts of the deceased as stipulated in the shareholder agreement. Failing an agreement between the parties, the spouse therefore remains a co-shareholder of Healthco. Furthermore, what about the claim for damages to which the estate is liable for breach of the shareholders' agreement? A complex issue that may end up in the hands of their lawyer!

The will should, in this case, either provide for a residual bequest of shares or a particular legacy conditional on the intervention of the legatee to the shareholders' agreement, in which case if the legatee does not comply with the shareholders' agreement, he simply cannot get his hands on the inheritance.

### Mr. Brilliant's idea... not so friendly after all

Ms. Francoeur's business is doing well... more or less. There are always risks, especially in the current economic environment. Since the incorporation of Immoco, Mr. L'Amoureux's wealth has considerably increased, while Healthco's is tenuous and has a more uncertain value. Ms. Francoeur is considering selling her company.

Mr. L'Amoureux wants to ensure that his spouse can maintain her standard of living after his death, while preserving an estate that he would like to bequeath to his children. Ms. Francoeur agrees with this. Along with Ms. Francoeur, he consults with his financial planner, Mr. Brilliant, with a view to calculating Ms. Francoeur's cost of living and to develop a strategy in the event that Mr. L'Amoureux passes away. It is established that the proceeds from the couple's life insurance and pension plans will be sufficient to cover Ms. Francoeur's needs, estimated at \$100,000 per year, after tax. Considering that his children are mature and responsible, Mr. L'Amoureux instructs notary Finicky to draft a will providing for a particular legacy of the shares of Immoco to his children in absolute ownership and the residue of his assets, which include some personal effects, pension and life insurance products, to Ms. Francoeur.

The couple finally sleep in peace until their neighbour, Mr. Shy, whom they see very rarely, tells them about the when he finds out that his children's inheritance of the common shares is invalid because the common shares no

legal dispute his family has been forced into following the death of their father. Upon his death, the father held a highly valuable real-estate investment company which he chose to pass on to his children. His widow and common-law wife, who shared his life for over 40 years, was the heir of his other assets, which were considered sufficient given her advanced age. During the settlement of the estate and preparation of taxes they realized that, without an agreement between the children and the widow, the widow's inheritance would go up in smoke. This was because of the tax burden resulting from the particular legacy for the children's shares and for which SHE, the heir, was SOLELY responsible! So now, for nearly three years, the family has been embroiled in an endless dispute...

Mr. L'Amoureux needs to change his will and provide for a particular legacy of the shares to his children dependent on the obligation by them to assume the taxes payable for the shares upon his death or even restructure his planning to name his children as the residual heirs.

### Mr. Smart's tax planning misstep

Healthco's business has picked up nicely. After taking a big gamble and buying a key competitor, growth has resumed and revenues are increasing year over year. A few good years have allowed them to build a comfortable retirement plan. Ms. Francoeur and Mr. L'Amoureux then agree that the common shares be left to the children of Mr. L'Amoureux. In any case, Healthco's shares are eligible for capital gains exemption and therefore will not result in any tax liability upon death. As for the remainder of Ms. Francoeur's assets, they felt it was time to give back to the next generation and designate XOXO Foundation as the residual heir of Ms. Francoeur's assets. Notary Finicky gets to work and the will is signed.

A few years later, our wealthy couple, when preparing their annual financial statements, talk to Mr. Smart about the possibility of freezing Ms. Francoeur's and Mr. Badlucky's shares in Healthco. They then convert their common shares into preferred shares. The common shares are issued in the name of a family trust such that, in case of the death of Ms. Francoeur, taxes will be limited to the capital gain on the preferred shares at the time of the freeze.

Shortly after completing this transaction, Ms. Francoeur becomes ill. She dies a few months later, leaving behind Mr. L'Amoureux and her stepchildren. Notary Finicky, during the reading of the will, reports that the stepchildren will inherit all Healthco's common shares in equal amounts. He informs them that the liquidator must transfer the shares to the children as payment of their inheritance.

Mr. L'Amoureux receives a call from notary Finicky, who has heard about the share capital restructuring as part of the estate freeze by Mr. Smart. Mr. L'Amoureux confirms this is the case. So imagine Mr. L'Amoureux's surprise

longer exist, having been converted into preferred shares. Instead, XOXO Foundation, the heir to the estate of the residual assets, will inherit all the Healthco's shares!

### How to meet the challenge of estate planning

As we just demonstrated in the story of Ms. Francoeur and Mr. L'Amoureux, estate planning is essential and should not be taken lightly. The absence of a will or poor estate planning can not only jeopardize the transfer and survival of your company upon your death, but also deprive your family of the inheritance that you have worked so hard to build.

Talk to your financial and legal advisors and make sure that your estate plan is worked out in collaboration with all the professionals involved in your company. If Mr. Smart, notary Finicky and Mr. Brilliant had worked together and developed a comprehensive and integrated portrait of their clients' business, the result would certainly have been more conclusive and consistent with Ms. Francoeur's and Mr. L'Amoureux's intentions. Do not forget that your will must be written as if a death was imminent. Any changes, whether they be to your intentions regarding your estate, your personal situation or the operating structure of your company, should be reported to your professionals and your will plans revised on a regular basis.

Draw up your will: it will not kill you!

---

**The content of this newsletter is intended to provide general comment only and should not be relied upon as legal advice.**

#### For more information, please contact:

**Jean-François Dorais, M. Tax**

Attorney  
514 925-6376  
jean-francois.dorais@lrm.com

**Pierre Girard**

Attorney  
514 925-6422  
pierre.girard@lrm.com

**Jean-Charles Hare**

Attorney  
514 925-6306  
jean-charles.hare@lrm.com

**Pierre A. Lessard, M. Tax**

Attorney  
514 925-6322  
pierre.lessard@lrm.com

**Catherine Tremblay, M. Tax**

Notary  
514 925-6369  
catherine.tremblay@lrm.com