FIRST YORK

Shareholders' Agreements – Planning Update

Ted Polci, CLU, TEP

I have just returned from the annual CALU (Conference for Advanced Life Underwriting) meeting in Ottawa. It was an excellent programme and we will upload articles to our "Library" at our website as soon as they become available.

Sometimes, the casual interaction between similarly interested members turns up some of the more useful information and this year was no different in that respect. I ran into a friend from Edmonton, Gary Clark, an outstanding insurance advisor, who has specialized in the funding of shareholders' agreements for many years, and he provided a heads up on an issue of importance to professional advisors.

There has been very little conversation on this matter, but it needs to be brought to the attention of those advisors who are dealing with shareholders agreements.

Most "share redemption" agreements were drawn before the new dual dividend rules for eligible and ineligible dividends were introduced. When a shareholders' agreement is underfunded - and one party dies – the agreement typically requires any underfunding to be spread over 3 to 5 years. In that event, the "survivor shareholder" will elect which pool of dividends will be used as the deemed dividend for the share redemption. Perhaps he/she will be fair, even generous, but the parties to the agreement should have an opportunity to discuss it now while everyone is alive and advisors can inform them on the issues.

Every situation will be different, of course, but one solution might be to provide that any underfunded amount be purchased by the surviving shareholders as opposed to redeemed by the corporation. Certainly, that will create a different result but it should be fair. There may be a capital gain on the underfunded portion in the deceased's estate. The dividend rate can be determined by the survivor based on circumstances, and further, the survivor would get a step up in cost basis for the amount purchased.

In any event, it is a good reason to have a quick review of the agreement to be sure clients deal with the issue proactively and there are no surprises at a difficult time.

I know many clients try to keep funding reasonably close to fair market value, but sometimes it isn't always practical or possible. A few changes to the agreement could save some tax and avoid problems later.