



MAKING SENSE OF BUSINESS VALUATION AND THE DUE DILIGENCE PROCESS

Presentation to the Windsor Estate Planning Council
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overview

(i) circumstances in which a business valuation is required; (ii) understanding valuation approaches; and (iii) undertaking proper due diligence

ESTATE PLANNING:
WHY IS IT IMPORTANT?

Fair Market Value (“FMV”)


- ▶ Tax legislation requires that all these transactions occur at fair market value; there is no definition of FMV in the Income Tax Act
- ▶ Fair market value is a term defined by common law as the highest price in terms of cash that would be paid by an informed and prudent investor, acting at arm's length, under no compulsion to transact, in an open and unrestricted market
- ▶ The determination of FMV is a question of ‘fact’ and not ‘law’ (refer to CIT Financial [2004] 4 C.T.C. 9 (FCA))

Price Adjustment Clauses & FMV


- ▶ A valuation is undertaken for Income tax purposes to support and give credibility to a Price Adjustment Clause (“PAC”), typically incorporated into an agreement to provide for an adjustment to the transaction price
- ▶ This clause reduces your exposure to tax and double taxation by retroactively adjusting the value of a transaction if ever reassessed by the CRA or a court of law
- ▶ As stated in paragraph 1.5(a) of the CRA’s Folio S4-F3-C1 Price Adjustment Clauses, a PAC will be recognized by the CRA when the agreement between the parties reflects a bona fide intention of the parties to transfer the property at FMV
- ▶ FMV must be determined using a “fair and reasonable method”
- ▶ CRA’s valuers follow the practice standards prescribed by the CICBV (see Information Circular 01-1)

Estate Planning Methods


- ▶ Most common estate planning methods that involves a transfer of beneficial ownership results in a disposition at FMV
- ▶ The proceeds of disposition do not necessarily have to be at FMV, which would trigger a realized gain/loss
- ▶ However, the FMV of the property transferred to the corporation must equal the FMV of the property taken back as consideration from the corporation

01. 

Section 85 – most used rollover technique

02. 

Section 86 – typically in a reorganization of capital; all shares are transferred

03. 

Section 51 – share or debt exchange

04. 

Trusts – deemed disposition rules

Other Common Estate Planning Reasons for Valuation

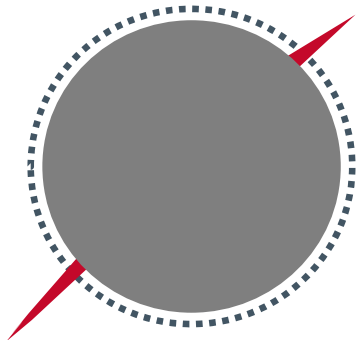
- ▶ Death of a Taxpayer
- ▶ Shareholder Benefits –Subsection 15(1) of the Act
- ▶ Donations of Property (“gifts in kind” to determine if there is an income inclusion that may arise)
- ▶ Becoming a Non-Resident of Canada
- ▶ Becoming a Resident of Canada
- ▶ Acquisition of Control of a Corporation
- ▶ Non-arm’s Length Transactions (e.g. FMV Consideration, Attribution)
- ▶ Gifting
- ▶ Private-company employee stock option transactions
- ▶ Renouncing U.S. Citizenship (U.S. Law)



Advantages

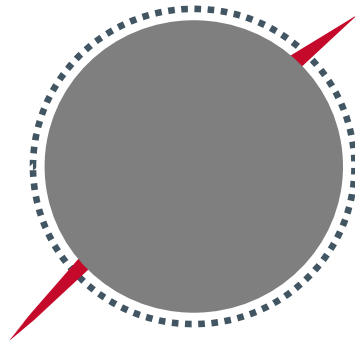
- ▶ Manage value and price expectations to close the deal
- ▶ Identify key value drivers to manage and enhance wealth
- ▶ Shareholder buy-out or dispute
- ▶ Matrimonial separation or dispute
- ▶ Business exit planning – increase value over time
- ▶ Basis for negotiations and price with potential purchasers or transfers to next generation
- ▶ Tax and estate planning
- ▶ Life insurance coverage
- ▶ Protection against estate administration tax (EAT) reassessments (pre-2013 probate fees)

Valuation Approaches



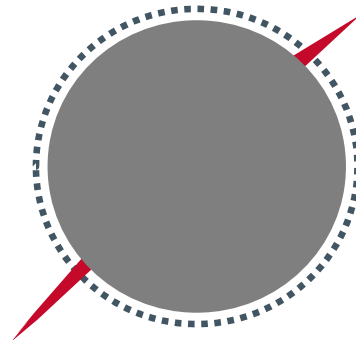
Asset-based Approach

- ▶ Adjusted Book Value/Net Assets
- ▶ Liquidation
- ▶ Holding companies



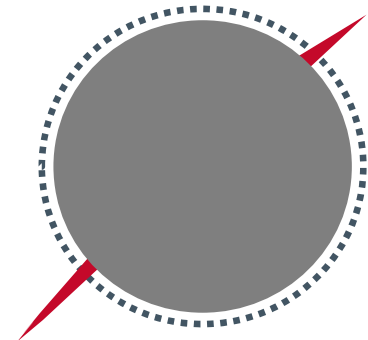
Income Approach

- ▶ Capitalized Earnings/ Cash Flow
- ▶ Discounted Cash Flow



Market Approach

- ▶ Comparable transactions
- ▶ Public market multiples
- ▶ Secondary approach



Rules of Thumb

- ▶ Secondary/ tertiary approach
- ▶ Revenue/Earnings Multiple
- ▶ Data sources

Valuation Principles

▶ Common valuation principles to consider when valuing a business interest and/or asset



Value is determined at a specific point in time



Value most likely does not equal Price



Hindsight or retrospective evidence should not be considered



No common approach – each valuation is unique



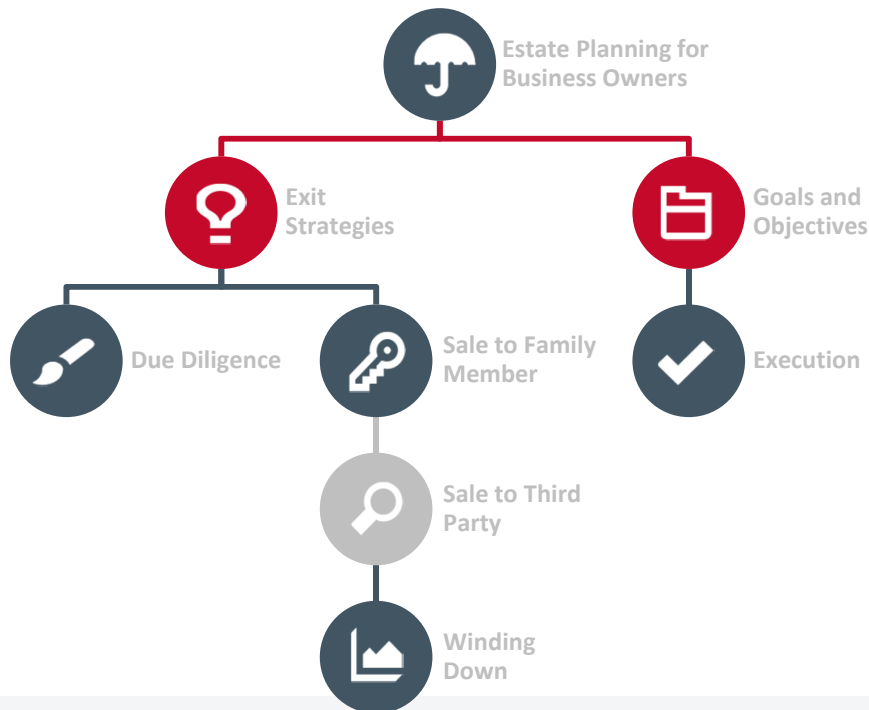
Value is based on the ability to generate future cash flows



Definition of value will vary depending on the circumstance

Due Diligence

- ▶ Good estate planning means proper exit strategy that meet the goals and objectives of protecting and preserving assets, proper distribution and minimize taxes, administrative expenses and delays



- ▶ Valuation Issues
- ▶ Deal Breakers
- ▶ Negotiation Points
- ▶ Identifying Hidden Value
- ▶ Warranties, Transition & Completion Issues
- ▶ Integration & Separation Issues

Due Diligence Process

- ▶ Preparation
 - ✓ Form and begin prepping your due diligence team
 - ✓ Bring in outside expertise as necessary
 - ✓ Create due diligence checklists and have data requests ready
 - ✓ Prepare a communication plan
- ▶ Execution and Issues Identification: Strategy/industry, Financial, Liabilities, Management
- ▶ Just looking under the hood isn't enough; you also need to know what you're looking for, and have the experience to know what you're seeing

Thank You. Any Questions?



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