Uncertain Times

Business and tax considerations for dealerships

Amid the economic challenges presented by the COVID-19 pandemic, dealership owners are likely looking at the various government support programs to help sustain their businesses. It will also be important to take appropriate steps to protect the equity previously created.

You always want to keep asset protection in mind — even more so in uncertain times. Consider the following strategies that may help to preserve the value in your business.

Use of a holding company

Business owners often use a holding company as a tool to accumulate the equity value built up by the business and, in many cases, hold valuable assets such as real estate or portfolio investments. Under an appropriate corporate structure, it is often possible to move annual profits earned by the business operations to the holding company by way of paying a dividend that does not trigger any immediate tax.

Under certain corporate structures, it is also possible to transfer existing assets from an operating company to a holding company without triggering any immediate tax. For example, real estate holdings may be rolled over into a holding company and kept apart from the operating entity.

Securing corporate loans

Businesses may have a holding company or individual shareholders that have loaned money to the operating entity for use in its business operations. These loans are often unsecured, which means the collection of these amounts may be at risk if the business runs into unforeseen financial difficulty. In these circumstances we recommend business owners discuss establishing appropriate security for the loan with their legal advisors. This will place the individual shareholder or holding company in a stronger position to recoup their investment.

In a group of dealerships, there may be loans between sister companies which are often non-interest bearing. In the unfortunate event the loan becomes uncollectible, the lender's loss on the bad debt may be denied for income tax purposes. In such cases, it may be worth considering structuring inter-company loans with an interest component, so the loan has an income earning purpose. This creates the possibility that the lender will be able to claim a loss for tax purposes if the debtor is unable to repay the loan.

Estate planning and freezes

The post-COVID environment has presented dealerships with significant challenges, including loss of revenue and in many cases, complete shutdowns. As a result, the fair market value of many businesses has seen at least a temporary decline. Many holding companies with investment portfolios have also reduced in value due to the recent performance of the stock market.

Estate planning may not be top of mind for business owners right now, but many face a significant tax liability on death with respect to the fair market value of their corporations. Shareholders may wish to consider undertaking an estate freeze to help minimize the taxes that will be payable on their death. A typical estate freeze involves a shareholder exchanging their common shares for fixed-value preferred shares which are equal to the fair market value at the time of the freeze. By freezing when values are low, shareholders can reduce the eventual taxable value in their estate.

In the event a shareholder has previously undergone an estate freeze, it may be worth considering a re-freeze transaction. In the event the value of the corporation has declined, it may be possible for the shareholder to exchange their existing preferred shares for a lesser number of preferred shares which reflect the corporation's current value. Again, this will help reduce the amount of estate tax that will be payable on the shareholder's death.

Keeping an eye to the future

You have spent a significant portion of your life building your business into a successful enterprise. Now is the time to protect the value you've created. Carefully review your structure to ensure it is set up in a manner that will offer the security you need now and for years to come.

To find out how MNP can help you optimize the resilience of your dealership business and position you for post-pandemic success, contact:

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