



## THE EUPHORIA OF SHAREHOLDERS' AGREEMENTS

*Why pre-agreed pricing methods and annual "maintenance" valuations smooth the road ahead*

### EXECUTIVE SUMMARY

Especially for first-time shareholders of a private business, the start-up phase—forming a company and drafting a shareholders' agreement—comes with much enthusiasm, and rightly so! Trigger events are often an afterthought (retirement, death, disability, deadlock, or voluntary exits), yet they're precisely when vague pricing clauses in shareholders' or buy-sell agreements get exposed. Pre-agreeing to engage an independent Chartered Business Valuator (CBV) to determine *fair market value*<sup>1</sup> (FMV) at the time of a trigger—and commissioning an annual "maintenance" valuation—creates clarity for all parties, streamlines financing, and builds an evidence trail third parties can rely on (banks, the CRA, and courts). This article outlines why shareholders and boards of directors should treat independent valuations as a core element of stewardship.

### A BRIEF OVERVIEW OF WHY FMV MATTERS IN BUY-SELL CLAUSES

In Canada, FMV is the standard of value used across tax and many commercial contexts. The Canadian Income Tax Act, R.S.C. 1985, c. 1 (5<sup>th</sup> Supp.), current to September 29, 2025<sup>2</sup>, contains 1,376<sup>3</sup> instances of the phrase "*fair market value*" in the English text, but it does not provide a statutory definition. In practice, CBVs align with the International Valuation Glossary – Business Valuation, updated February 24, 2022<sup>4</sup>, a document co-produced by the CBV Institute, and to CRA guidance and jurisprudence. Key reasons FMV belongs in your agreement include:

- It is an objective standard developed through jurisprudence, supported by the CRA in its non-binding guidance, and is determined by CBVs who apply recognized methods consistent with professional standards.
- Courts frequently adjudicate FMV disputes; a qualified independent valuator can improve the credibility of evidence.

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<sup>1</sup> Fair market value is "a standard of value considered to represent the highest price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, each acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or to sell and when both have reasonable knowledge of relevant facts." Source: International Valuation Glossary – Business Valuations; as updated February 24, 2022.

<sup>2</sup> <https://laws-lois.justice.gc.ca/PDF/l-3.3.pdf>

<sup>3</sup> This figure is an approximation based on uploading the above PDF into ChatGPT 5 (Thinking) and requesting an exact count of each instance of "*fair market value*", because, in short, we weren't about to count them ourselves.

<sup>4</sup> [https://cbvinstitute.com/wp-content/uploads/2021/11/International-Valuation-Glossary-Business-Valuation\\_EN.pdf](https://cbvinstitute.com/wp-content/uploads/2021/11/International-Valuation-Glossary-Business-Valuation_EN.pdf)





- A clear FMV mechanism in your shareholders’ agreement can reduce periods of stalemate, litigation risk, or tax surprises – often at the worst possible time.

## COMMON BUMPS IN THE ROAD FOUND IN SHAREHOLDERS’ AGREEMENTS

While shareholders’ agreements are legal documents that should be drafted with legal counsel, here is a non-exhaustive list of items to consider from an independent valuator’s perspective:

- **Vagueness on the standard and level of value:** in the euphoric phase of starting a business, a shareholders’ agreement may reference “fair value” or “fair market value” without definitions, or say “price (or multiple) of shares to be negotiated”, or it may be silent on the application of majority/minority or liquidity/marketability discounts; this ambiguity can be susceptible to interpretation at some later date and may require costly resolutions;
- **The role of normalization adjustments:** certain one-time or non-arm’s length items, either positive or negative, may distort business income in any given period. A shareholders’ agreement specifying that an independent valuator will normalize owner compensation, related-party transactions, one-time items, and other discretionary or non-recurring items can ensure each shareholder receives fair and reasonable consideration at any given valuation date;
- **Date and frequency:** specifying the frequency of valuation reports and valuation date(s) within a shareholders’ agreement, similar to the regular preparation of financial statements, can be thought of as part of good governance offering transparency to shareholders and keeping expectations current (generally on an annual basis). Further to this, upon a specific trigger event, prior agreement to set the valuation date to, for example, the day immediately preceding the trigger event, can reduce ambiguity and lead to expedited settlement;
- **Independence:** a shareholders’ agreement that states a valuator must act independently and objectively, per CBV Institute practice standards, is generally considered best-practice and broadly aligns with expectations of courts, the CRA, and other third-parties such as lenders. A valuation prepared by the business owners, or their accountant, could be seen as lacking independence and objectivity appropriate in certain instances and is a good bump in the road to avoid.

## A CHECKLIST FOR SHAREHOLDERS OR BOARD MEMBERS

- ✓ Does the shareholders’ agreement define FMV and level of interest (control vs. minority stake)?
- ✓ Is an independent CBV expressly required with a defined selection, or tie-break, process?
- ✓ Are there clear expectations established for normalizing cash flow or income?
- ✓ Are valuation-related timelines spelled out: information/documentation access; preparation of a draft report; comment window on the draft; costs and payment arrangements; release of the final report?





- ✓ Is there direction to record in the minutes that the final valuation report was received and to document any decisions/actions taken?
- ✓ Is there an annual “maintenance” valuation requirement to keep FMV current?

### CLOSING THOUGHTS

Whether buying shares from an existing shareholder, issuing shares through an option plan, satisfying the estate of a deceased shareholder, or simply maintaining governance standards, private companies turn to independent business valuers for many reasons. We encourage shareholders and board members to embed independent valuations into their shareholders’ agreement and to adopt annual valuations as part of governance – benefiting stewardship this generation, and the next.

Thank you,

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### REFERENCES

1. Income Tax Act (Canada): <https://laws-lois.justice.gc.ca/eng/acts/l-3.3/>
2. International Valuation Glossary – Business Valuation (2022): [https://cbvinstitute.com/wp-content/uploads/2021/11/International-Valuation-Glossary-Business-Valuation\\_EN.pdf](https://cbvinstitute.com/wp-content/uploads/2021/11/International-Valuation-Glossary-Business-Valuation_EN.pdf)

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