



# *Family* Business Matters

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Spring 2010



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*Family* Business Matters



***Harnessing the full potential of a family business, while satisfying the expectations of family members, is difficult but certainly achievable with the right kind of help.***

*Regardless of the economic times, running a family business is a juggling act. The needs of the business to grow and prosper have to be balanced against the needs and expectations of family members.*

*While strategic primary concerns of any family business can include profitability, business growth, planning, and issues, such business concerns are overlaid with specific family considerations, the most important of which are balancing short- and long-term business decisions, maintaining the loyalty of family members, and the grooming of willing and able successors.*

*Renowned for resilience, family businesses inherently have the flexibility and resolve required to be best positioned for growth and to adapt more easily to change.*

*Family business inspires entrepreneurial talent, and it is with this in mind that we share this compilation of articles. We hope the insight proves helpful to the continued growth and success of your business.*

**Beverly J. Johnson,**  
CA, PAg, Partner, National Chair,  
Family Business Committee, KPMG Enterprise™



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# Shareholder Agreements in the Family Business

**Don Zinyk**, Consultant to Business Families Executive Professor, Alberta Business Family Institute



**Most, if not all, families whose family business has grown to encompass two or more generations, know the importance of having a shareholders agreement. Yet, in spite of this knowledge, many families find it extremely difficult to get shareholder agreements drafted, and even more difficult to get one signed and implemented. This article explains why so many families encounter such difficulties and what can be done to resolve them.**

Many people would be surprised by how many families start the process of drafting shareholder agreements without having a clear idea of what they hope to accomplish. In many cases, an accountant or lawyer has told them they should have an agreement, so they embark on the process to get one. Typically, the founder will meet with the lawyer and give them broad instructions as to what they want to have happen in the event that one of the shareholders encounters one of the so called four Ds—death, disability, divorce, or disenchantment. The lawyer drafts an agreement, minor revisions are made, and then a revised draft is ready for presentation to the family. The founder, who is often quite proud of himself for getting this far so quickly, is flabbergasted to find that the family doesn't agree with the contents of the agreement. Arguments often ensue and because many families do not have an effective way of dealing with conflict, the agreement sits in draft form unsigned and gathering dust.

In this situation, what the family has failed to realize is that drafting the shareholders' agreement in a family business is different than drafting one between two or more arm's length shareholders. Whereas shareholders who deal at arm's length

tend to understand and accept that each party will work in their own best interests, shareholders who share family ties often make the erroneous assumption that they know what is in the family's best interests. They fail to realize that in many respects, a shareholders' agreement in a family business is a balancing act between two generations that often have very differing views of the world. We would not suggest that founders should abdicate their rights with respect to their shares to the next generation; however, we do suggest that founders have an obligation to make their plans known to the next generation, and to discuss those plans with them.

The starting point for an effective shareholders' agreement in a family business is an in-depth discussion that includes the entire adult family. If the family has a family council, the discussion should be held there; if no council exists, a facilitated meeting of the family to discuss the key issues pertinent to a shareholders agreement is advisable. While families might think that some of the issues are relatively straight forward, differences in family values can often make what is an easy issue in one family very complex in another. For example, one large Canadian business family has a stipulation in their shareholders'

agreement that shares of the corporation can only be passed to a direct blood descendent of the founder. This means that if a shareholder dies, his shares can only be passed to his biological children. He cannot pass the shares to his spouse or his adopted children. While many families might find this provision onerous, the large family who adopted it finds it perfectly natural. Similarly, whereas many shareholder agreements call for an almost immediate pay-out upon death, others require a pay-out over time. The final agreement is often as unique as the family it covers.

The important point is for the family to have an open and honest discussion of the issues. A facilitator is important to this process because, through experience, we have witnessed many of the younger generation to be uncomfortable talking to their parents about their parents' death and the ultimate disposition of the estate. An experienced facilitator will help ensure that the meeting environment is conducive to an open discussion and that all family members have an opportunity to be heard. Only when the family has discussed all the important issues and reached a consensus, should the actual work upon the details of the agreement start.



Once the family has a consensus of what they are trying to accomplish, I would suggest a meeting with the family's tax advisers and insurance providers. Because shareholder agreements often mirror the parents' estate plans, it is important that the stipulations of the agreement be tax effective. Similarly, because few families have sufficient liquidity to pay the taxes that can be due upon death, it is important to consider funding the shortfall with life insurance. Life insurance can also be a necessity where parents want to leave the shares of the business to some children but not others. The additional liquidity provided by the insurance allows the parents to treat each child fairly, even though the allocations are not equal.

Once an agreement has been drafted, it is important for the signatories to the agreement request that it be reviewed by their own advisers. This is particularly true if the agreement was drafted by a lawyer who has a long track record of working for the parents of the company. While some might consider this a waste of money, it is important that everyone party to the agreement speak to someone who represents only their interests about the impact of the agreement on them. Only after everyone has benefitted from such advice and is happy with the agreement should the actual document be signed.

There are two words of caution always given to families soon to embark on the preparation of a shareholders' agreement. The first is to start early, before there are any health crises or matrimonial disputes on the horizon. Reaching an agreement on some issues is difficult even when the family is discussing hypothetical events. In the circumstance of an unfavourable medical diagnosis or a pending divorce, the discussions can be almost impossible. The second word of caution is to be prepared for the time it will take to complete an agreement. Even families who have family councils and conflict resolution mechanisms find that shareholders' agreements can take a long time to bring to fruition. For example, one close and motivated family took 2 years for four siblings to discuss and agree upon the issues that were important to them in their agreement. Once the agreement is completed and signed, it is important to avoid the temptation to file it and forget it. The family dynamic and businesses change constantly, and it is important that the agreement be reviewed periodically to ensure it still meets the needs of the shareholders. We have been privy to situations where the growth in the company's value made the provisions of the shareholders' agreement unworkable, and we have also seen situations where changes in a shareholder's marital status

led to significant unintended consequences. Generally speaking, shareholder agreements should be reviewed every 3 to 5 years.

Unanimous shareholder agreements are an important part of a successful family business. The agreement will assist in laying the ground rules for new family members coming into the business as shareholders. It also outlines what happens on exit or other life-altering events. Having a shareholders' agreement in place may prevent unpleasant surprises and allows the shareholders' energies to go into running the business, rather than dealing with conflict.

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*Don Zinyk is an Executive Professor in Family Enterprise at the University of Alberta, School of Business. Don Zinyk was a partner in the owner-managed business group of KPMG's Edmonton office. Mr. Zinyk's areas of focus are succession planning, tax and financial planning as it applies to family businesses and general financial services. With over 30 years of experience as a partner, Mr. Zinyk has devoted his career to providing services to family and owner-managed businesses. For the past several years, Mr. Zinyk has focused in the area of succession planning and has assisted several business families plan for the transfer of their business to the next generation.*

# Ready for *Opportunity*

**Richard M. Sifton**, President, Sifton Properties Limited



*For companies worldwide, the current economic climate has been a challenge. Sifton has certainly felt the impact of these uncertain times as well. We have always believed if we are able to see challenges as opportunities, we will be well positioned when the markets recover. Our most important priority for 2010 is to continue to ensure the company is well prepared for the opportunities that lie ahead.*



**A** downturn is typically less motivating for staff. Colleagues in other industries are being laid off, friends are challenged with debt, and they too begin to feel at risk. At Sifton, our staff has become a valued part of our extended family. And, as family, we want to ensure they feel secure. We've worked with staff to keep them energized, ease their concerns, and communicate our vision for the future.

These times have encouraged us to not only be more innovative, but also to consider and seek out different types of opportunities. We're encouraging staff to take on new challenges with confidence and identify opportunities as they arise. Whether it is finding ways to improve productivity or further improve our customer relations, with a solid understanding of our business model, our goals, and our targets, they are empowered to make decisions to ensure we stay on target.

***Sifton Properties Limited** is a privately held, real estate company servicing Southwestern Ontario and Mississauga. Since its beginnings in 1923 as a builder of new homes and neighbourhood developments, Sifton has earned an enviable reputation for exceptional quality and outstanding customer service.*

*The spirit of innovation that shaped the corporation in its earlier years continues to keep it at the forefront of today's construction industry. Today, Sifton has diversified into office construction and leasing, residential rental accommodation, seniors' retirement lifestyle communities and accommodation, and property management.*

*With over 900 employees, Sifton continues to grow and expand conservatively, which is why it was recently recognized as one of the 50 Best Managed Companies in Canada.*



Experience. The Difference.™



Making sure our employees are prepared for a changing economy has been our first step. The next step is ensuring we are ready with our product. You need to be ready now, not when the economy has already changed. We want to be ahead of our competition, not following them.

That is why approvals for land projects are currently underway, new house plans are being finalized now, and work continues for the grand opening of a new retirement home. Planning takes time, and what better time to get ready than when our operations are slower. Now is the time to prepare for a busy and prosperous 2010.

Tied to our products being ready, we have also worked to ensure we have the capital in place to implement our growth plans. Our banks have performed reviews and are ready to lend more when we need it.

Having our employees, products, and financing ready for future growth is Sifton's number one priority. We will spend 2010 inspiring our staff to take on new challenges in the spirit of innovation that puts Sifton at the forefront of our industry.

# Customer Focus **First**

**Murray Flanagan**, Senior Vice President/Treasurer, Flanagan Foodservice



The past 18 months have been an unprecedented time in the global economy. As with most businesses, Flanagan Foodservice was faced with challenges we have never experienced before. For the first time since the GST was introduced in 1991, we saw our industry produce negative growth. The pressures put on our customers flowed into pressures for us. Our customers needed to manage their financial burden, and one way they did this was to raise their expectations of their food distributor. They had to re-evaluate the value of their purchases, look for less expensive options, and, in some cases, set aside their loyalties to protect their existence.

We have been successful through this time by continuing to put our customers' needs in front. We have worked with them to find products that suit both their menu and economic requirements. As a result of this focus, we were able to protect the loyalty of our existing customer base and gain market share at the same time.

In addition, 2009 required us to look at every area of our business to find ways to provide our service more cost effectively. It was critical to us to do this in a way that was transparent to our customers. In the end, the level of service had to remain at the high standards we built our business on. With a great deal of support from our entire team, we were successful at finding opportunities for cost reduction.

We expect 2010 to look a little different; on the road to economic recovery, we will focus on two particular areas to continue as a successful family business.

First and foremost, we must continue to never take our customers for granted. They entrusted us through the difficult times and, as their business slowly turns around, we will need to keep earning their trust every day. Each of their needs is different and continually evolving. We need to constantly work with them through this evolution to maintain their support for the long term.

Secondly, we need to ensure that we do not lose ground on the efficiency we have gained through this recession. Pressure on our margins will continue for some time to come. Our cost model must be tight enough to allow for that. Once again, this must be done without sacrificing the value we provide to our clients.

Being in a family business gives us the ability to make the necessary adjustments on a daily basis that will allow us to achieve the results required for long-term viability.

*Flanagan Foodservice is an independently owned and family operated company that continues to evolve within the foodservice industry. Joe Flanagan founded the company in 1977 with an emphasis on customer service. His four sons have maintained this focus, and by always putting customers first, they've enjoyed 32 years of consistent growth and expansion.*

*Success comes from listening to the needs and ideas of their customers and employees. Flanagan Foodservice constantly improves by refining services, systems, and product mix, and by offering the flexibility to meet their customers' challenges and evolving needs. For more information, visit: [www.flanagan.ca](http://www.flanagan.ca).*



# Planning *for* the Future

**James McKenzie**, President, Monk Office

Like in so many Canadian industries, 2009 was a year of change in the world of office and business supplies. At Monk Office, it was a year of reflection—taking a new perspective on how we do business with our customers today, and how we will both retain those same customers and earn new ones into the future.



After more than 25 years of being involved in the day-to-day operations at Monk Office, 2009 presented me with a unique opportunity to step back and plan for the next 25 years of the business. At the end of my 6-month sabbatical, I came back to the business with new perspective on the company and a renewed vision for the future. I knew we needed to take Monk Office from being a “very good” company to work with (which is what all our customer surveys tell us) and for, to really being a GREAT company.

What makes for a GREAT company? That’s the challenge we started to tackle in 2009 and will work forward with in 2010. To begin, we closely examined all areas of the company and clearly defined those things that create an extraordinary experience for our customers—those moments of truth with our customers that make a difference in their lives. With thousands of the best business products and helpful, professional services, Monk Office has more than 100 hundred helpful office people who pride themselves on taking very good care of your office needs. That’s why our mission statement is

“Knowledgeable People Passionate About Your Personal and Professional Success.” Being a great company means embodying our mission statement.

My sabbatical also gave me the opportunity for succession planning in our family owned business. Much as my father instilled strong family values into the business and me, I endeavour to do the same with my own two children.

2009, although a tough year for many, saw new light shed on the way we do business at Monk Office. It’s years like 2009 when we need to weather the storm and do things differently, which give us new insight into how to move into the future. It’s years like 2009 that teach us how to better serve our customers and each other.

It’s years like 2009 that make us a stronger—both as individuals and as a company.

In 2010, our top priority at Monk Office is taking what we have learned and planning for a successful future.

*Monk Office began in 1951 as Murphy Stationery (Victoria) Ltd, a small stationery store in the heart of downtown Victoria. In 1956, Charlie Monk purchased the company and changed the name to Monk Office Supply Ltd. Seven years later (1963), the business came under the ownership of the McKenzie family.*

*James McKenzie entered into the family business in 1982 along with his brother. Together with their father, they proceeded to re-invent the family business into a multi-faceted organization using technology and defined processes to support growth. Monk Office, as it is now known, has 10 retail locations on Vancouver Island, an office furniture showroom, and a 26,000 square foot distribution centre that contains the office products and furniture warehouses and head office.*

*After more than 55 successful years, Monk Office remains the only locally owned and operated office products dealer on Vancouver Island. Since the doors first opened, Monk Office has been passionate about helping businesses succeed.*

# Tax-Effective Retirement and Estate Planning

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## *Consider a Family Trust in an Estate Freeze*

**John Warren, CA**, Senior Manager, KPMG Enterprise

*Many business owners use family trusts to help them reduce their income taxes and pass their businesses on to the next generation in a smooth, tax-efficient manner. This article highlights how family trusts work and should help you decide whether one might be right for you.*

A trust is very flexible. Any income earned by a trust can be taxed in the trust itself or, alternatively, all or some of its income can be allocated to the beneficiaries to be taxed in their hands. In a typical family trust, there are no restrictions when deciding who gets allocated what income, and in what proportions.

A family trust can also form part of an “estate freeze” plan, which can help lower the taxes your estate will have to pay on your death. Estate freezing involves taking steps to fix the current value of your shares in a family business so that future growth will accrue to the benefit of others, such as your children or the trust, and not be taxed on your death. As long as the freeze is structured properly, you can maintain control of the business.



### ***Here's an example of how an estate freeze might work with a family trust:***

Let's say Sarah owns all of the common shares of her incorporated business, FamilyCo, and the company has grown in value and is worth \$5 million. She is interested in the possible income splitting benefits of transferring growth shares to other family members, but is nervous about how much future value she might be giving to her children on any transfer. If the value of the company continues to grow, Sarah wants the flexibility to "take back" some of that growth for her retirement.

As part of the estate freeze, Sarah's mother will settle a family trust for the benefit of Sarah, her husband, and two children (ages 16 and 20). Sarah will act as the sole trustee of the trust and make all future decisions regarding the trust property.

Sarah will exchange all of her common shares in the company for fixed value preference shares (worth \$5 million), and the family trust will arrange to borrow from a bank the nominal amount of \$1 that is required for it to purchase newly issued common shares of FamilyCo. Sarah will retain voting control of the company by

having voting rights on the preference shares, or by virtue of her controlling the trust as sole trustee.

FamilyCo will then be able to pay dividends on its common shares, which will be received by the trust. As trustee, Sarah has the ability to direct the trust to allocate these dividends to be taxed on any, all, or just some of the beneficiaries' personal income tax returns, in whatever proportion that she chooses.

In the case of her university-aged child who has no other source of income, depending on the situation, that child could receive up to about \$40,000 per year in dividends without incurring federal income tax and only nominal provincial tax (an even higher amount can be received once tuition credits are taken into account). This is a much more tax-effective method of providing income to the child than paying salary or dividends to Sarah (taxable at the highest marginal rates of about 46 percent and 31 percent, respectively) without having to give direct ownership of the shares to the child.

Should FamilyCo receive an offer to purchase all of its shares, any gain realized on the sale of the common shares by the family trust could be taxed in any proportion to the family members that are beneficiaries. This would allow for the possibility of using each of the beneficiaries' \$750,000 lifetime capital gains exemptions. By having Sarah's husband and the two children as beneficiaries of the trust, the family has gained access to three additional exemptions of \$750,000, possibly sheltering up to an additional \$2.25 million of capital gains on the sale of the active company.

Once a clear successor emerges or has been chosen, the trust could distribute the common shares to any, all, or just some of the beneficiaries. Even though the shares may have significant value at that time, the beneficiaries could receive the common shares from the trust tax-free—the beneficiaries would simply inherit the trust's cost of the shares (\$1). If Sarah evaluates the beneficiaries and ultimately decides she should retain the common shares herself, she could decide to distribute the shares to herself, as a result of being one of the beneficiaries.

The use of a family trust can be much more complicated than this simple example and should be executed properly to ensure it achieves your goals; you should get qualified professional advice before undertaking this type of tax planning. Because trusts are so flexible, there are many traps for the unwary that may result in a loss of the benefits outlined above.

As part of an estate freeze, the family trust provides for the flexibility of distributing annual income (including dividends or capital gains) to beneficiaries, without committing to the allocation of future growth. At all times, the trustees have the

ability to decide who gets what, when, and how, possibly to the exclusion of some, holding ultimate control over the trust property (the common shares). The family trust can also be used to distribute additional value to the "freezeor," even after the date of the freeze.

A family trust can allow you to delay the decision over ownership of new growth shares, while still freezing the value of your company for your personal estate tax purposes.



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# Effective Retirement Planning

## *Maturing Your RRSP*

**Paul Woolford**, Partner, KPMG Enterprise

If you are an owner of a family business who is preparing for retirement, you need to think about how to use your retirement savings, including your RRSPs, in the most tax-effective way. You will have to mature your RRSP by the end of the year in which you turn 71. There are four basic ways of getting your money out of a mature RRSP, which can be used by themselves or in combination. Whichever of these options or combinations you choose could greatly affect the quality of your retirement and the funds available to your spouse or other heirs after your death.



***Before you consider the RRSP maturity options outlined below, you should assemble a clear picture of your other investment assets and income sources. You should also project your annual cash flow needs, making sure to account for inflation.***



***Paul Woolford*** is a Partner in North York with KPMG Enterprise. He assists private companies with all facets of the financial and tax issues surrounding their businesses. He advises on matters such as tax-efficient structures, acquisitions and divestitures, compensation planning, estate planning, and providing coordinated tax advice for owner-managers of Canadian controlled private corporations. He can be reached at (416) 228-7062 or by e-mail at [paulwoolford@kpmg.ca](mailto:paulwoolford@kpmg.ca).

## 1 Purchase an annuity

One way to mature your RRSP is to purchase an annuity, which will provide you with a steady income stream over the life of the annuity. The RRSP proceeds will not be taxed immediately; the annuity payments will be taxed as you receive them. Tax on up to \$2,000 per year of the income may be reduced or eliminated through the tax credit for pension income.

There are three general kinds of annuities:

- “Term certain,” payable to you or your estate for a fixed number of years
- “Single life,” payable to you as long as you are alive
- “Joint and last survivor life,” payable as long as either you or your spouse is alive. Each of these annuities can be tailored through a variety of options to suit your needs.

## 2 Transfer your RRSP funds to a RRIF

You can also convert your RRSP into a Registered Retirement Income Fund (RRIF). A RRIF is somewhat like an RRSP, in that you can have it invested in various kinds of securities. However, you must withdraw at least a “minimum amount” from the RRIF each year and report what you withdraw as income for tax purposes. (Again, tax may be reduced or eliminated by claiming the pension income tax credit of \$2,000.)

The amount that must be withdrawn from the RRIF is a fraction of the value of the RRIF at the beginning of the year, which increases gradually each year based on your age, levelling out at 20 percent once you turn 94. You may use your spouse’s age for the calculation of your RRIF minimum withdrawal amounts instead of your own. Doing so may allow you to extend the tax deferral on the funds if your spouse is younger than you are.

## 3 Convert locked-in RRSP to a LIF

Depending on the terms of the plan and relevant legislation, a Life Income Fund (LIF) provides an alternative to a life annuity when individuals who were formerly members of a registered pension plan terminate employment or plan membership. The LIF is also an option for individuals who have previously transferred pension funds to a locked-in RRSP.

## 4 Withdraw the funds and pay the tax

Another option is to cash out some or all of your RRSP by simply withdrawing the funds. However, this option it is the most expensive route in terms of tax—the entire amount withdrawn is included in your income in the year of withdrawal and taxed as ordinary income, just as if it were salary.

### Using TFSAs in retirement

Once you have wound up your RRSP, a Tax-Free Savings Accounts (TFSA) can still play an important role in your retirement plan. Though your contributions to this new type of investment account are not tax deductible, the income and capital gains earned will be tax-free. As long as you have TFSA contribution room, any income you receive once you are required to start drawing down your registered retirement savings can be invested in a TFSA, such as excess after-tax funds received from an annuity or RRIF. The TFSA cumulative contribution limit is \$10,000 in 2010 and will increase by at least \$5,000 annually.

### Pension income splitting

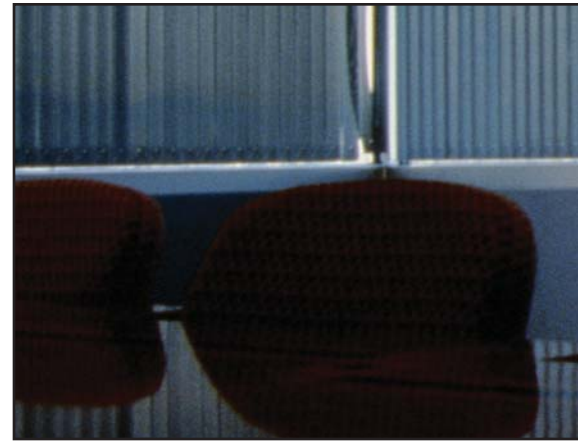
You may also be able to split some of your pension income by transferring up to 50 percent of your income eligible for the pension income credit to your spouse or common-law partner. This credit applies to private pension income received through a life annuity, annuities out of an RRSP or a deferred profit-sharing plan, a payment out of an RRIF, or the income portion of a regular annuity.

The amount of split pension income that will produce the most tax savings will vary greatly among couples, depending on the income of each spouse.

### Weigh the alternatives

While your personal cash flow needs should be your primary concern in weighing your RRSP maturity options, your decision—whether one option or a combination of several—should take into account your overall investment and estate planning goals.

# Does Your Business Family Need **Family Meetings?**



**Bill Corbett**, Partner, KPMG Enterprise

The answer is absolutely “yes,” based upon my years of experience in working with family business. While there are many reasons, most relate to communication. While many families know that they do not communicate effectively, others think that they do until a significant issue arises, which is when they learn that they do not have the tools to deal with the challenge. Family meetings, which are named “Family Councils” by the Canadian Association of Family Enterprise (CAFE), help communication and are a key to successful governance in family business.

## When to start

If the “elephant in the closet” is already out and raging, the family will have a hard time focusing on the process and skill building to develop their Council. While it can be started in times of crisis, it can be better built when no major issue is tearing at them. By building an effective Council, the family will have the skills to handle the issues that arise in all families from time to time. One of the business families whose meetings I facilitate recognized the merit of starting their Council before their children completed their schooling. They saw the merit in starting early because of the agony that they went through when the business passed from the founder generation. Having an effective Council in place will enable this family to better handle issues that will arise. Further, by communicating now on many topics, the number and severity of issues that they face is going to be lessened.

## Energizing the process with a facilitator

CAFE highly recommends using a facilitator to build your Council, and KPMG Enterprise has a number of experienced and trained facilitators that can help. Look for someone with knowledge of family business and facilitation experience. There should be consensus by your Council family members on the chosen facilitator, as “chemistry” will be important. Committing to a meeting time with an outside facilitator can be the difference between making the meetings happen and deferring them indefinitely because everyone is busy. The time investment is not huge, as most Councils meet for three or four afternoons in year one, and then less once established. Engaging a facilitator helps demonstrate that the “family” part of “family business” is valued.



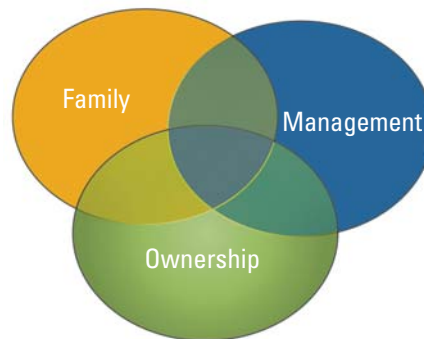
## What do business families talk about at family meetings?

Initially, your facilitator will work with you on developing guidelines and processes to help your Council be effective when tough issues arise. First agendas might include development of a code of conduct, a conflict management agreement, and a Family Council Charter covering operations.

With some basics in place, the family may look at some big picture topics and skill development. Big picture topics might include outlines of family and business history, discussions of individual and shared values, stewardship responsibilities, and a family mission statement. Skill development of universal benefit includes work on effective talking and listening, with a focus on listening. Problem solving is a key skill that might sound simple, but work is usually required to replace existing power systems and inherent emotion that exist in most families with openness and respect for each other's perspective.

Issues in business families are inevitable because perspectives of family will often not be the same. The three circle model that family business gurus and CAFE describe does explain some of this

difference in perspective. With some of the family only in the family circle, with some in family and ownership circles but not in the business management circle, and with some in all three circles, perspectives will obviously be different.



The Family Council can help in clarifying boundaries so that all the family can understand that family emotion should not be running business management. By not keeping the family in the dark about big picture things going on in the other two circles, potential conflict is alleviated. With an effective Family Council, family issues have a place to be resolved, which also helps keep them out of the business management circle. Quality family meetings can provide the place for some

family input into matters such as opportunities for successor generations, ownership, and succession.

From the initial meeting on, each session should include celebration. This is an opportunity for recognition of achievements of family members and business. Ensuring meetings are booked away from the business and the home helps offer a safe and undistracted setting for work and fun. A private dinner at a special restaurant with the family meeting attendees is a great way to close each session.

## How to measure success for business families

For virtually all family business, the financial well-being of their family and the continued success of their business are goals that we at KPMG Enterprise have contributed to for years. However, from my work in facilitating family meetings and succession planning, I have learned that avoiding family disputes and enhancing understanding and peace amongst family members is just as valued by the most successful business families. Quality family meetings really help! Start soon.



*Bill Corbett is a Partner in Kelowna with KPMG Enterprise. Over the past 30 years, he has applied his CAFE and KPMG Enterprise succession planning learning to assist many BC private companies resolve conflict and work through transitions in management and ownership. He can be reached at (250) 979-7155 or by e-mail at bcorbett@kpmg.ca.*

# Governance for the Family Business

Gordon D. Moore, FCA, Partner, KPMG Enterprise

Since the Enron collapse, a great deal of attention has been paid to corporate governance. This added scrutiny has had a positive influence on governance for family businesses. Canada now boasts several universities with faculties or departments devoted to the study of family business, and there is a steady stream of new research covering this vital segment of the economy.

*Better governance of a family business can help improve business performance and satisfy the expectations of all family members.*

Thankfully, some of this research has lifted the veil of secrecy that surrounded many family businesses and changed the public's perception of how family businesses are governed. Not that long ago, many considered family business governance to be an oxymoron, roughly equivalent to jumbo shrimp. Unfortunately, such beliefs demonstrated a lack of understanding of how family businesses develop and thrive as vital contributors to our economy and the business community at large.

The most widely accepted conceptual model of family business growth and governance was the transition concept developed by Gersick, Davis, Hampton & Lansberg.<sup>1</sup> In this model, family businesses can be broken down into three different stages.

The first being the Founder or **Controlling Owner** stage, in which management and ownership rests in the founder's hands, or sometimes those of a husband and wife. Governance structures at this stage are usually informal. The founder will typically rely upon a relatively small circle of advisers or business associates, and will make most of the key decisions personally. Due to the fact that family involvement is usually limited at this stage, there are seldom any formal governance structures in place. Although governance is informal, it is still important. This is often the stage where family values are engrained in the business and where the responsibilities of ownership are imbued in the next generation.

The next stage is the **Sibling Partnership**. At this stage, the founding parent or parents have reached the end of their working lives and have transferred ownership of the business to their children. In the Controlling Owner stage, management and ownership rest in very few hands; in the Sibling Partnership stage, it may rest in many. Whereas the founding owners typically worked in the business, it is not unusual at the Sibling Partnership stage to have some owners working actively in the business and others pursuing separate careers. In the Controlling Owner stage, the founder often makes decisions on the basis that what is good for the business is usually also good for the family. The leader of a Sibling Partnership business, however,

often has to balance the needs of the business with the needs of several families, not all of whom get their livelihood from the business. Governance at this stage is moderately complex.

Because family involvement is now greater and more extended, it is often necessary to implement a structure to formalize communication and allow all adult family members a say in how the family and business interact. Family Councils can provide a mechanism to help reduce the conflict that so often occurs in family businesses.

The Sibling Partnership family business is usually larger and more complex than those in the Controlling Owner stage. As a result, the governance needs are more pronounced and often involve either a formal Board of Directors or an informal group of advisers who will fulfill many of the duties carried out by a formal board.

The third stage of the family business occurs when the siblings of the Sibling Partnership pass the business on to their children, thus forming a **Cousin Consortium**. While Cousin Consortiums can take many different forms, they are typified by diverse ownership and management that is often not part of the original family. These businesses are typically complex and have more complex governance needs. In fact, many grow to the size where people stop thinking of them as family businesses. SC Johnson, McCain Foods, Cargill, and Ford are just a few examples of Cousin Consortium family businesses.

In addition to the Family Councils and Boards of Directors found at the Sibling Partnership stage, Cousin Consortiums, by necessity, often have formal governance structures in place to deal exclusively with shareholder rights and responsibilities with respect to the family business. One Canadian family business has annual sessions where children as young as 10 are introduced to the family business and trained in the obligations they will one day face as owners.



One of the interesting differences between family and publicly-owned businesses is the fact that family businesses often change their structure. It is not unusual for a family business at any of the above stages to move to any other stage. If one sibling buys out a brother or sister, the business may revert from a

Sibling Partnership to the Controlling Owner stage, where ownership again rests with a very small group. A large Canadian business now entering its sixth generation went from the Controlling Owner stage to a Sibling Partnership, and then back to Controlling Owner before it grew to the Cousin Consortium it is today.

Regardless of the stage, there are a number of factors that make family businesses' governance needs unique. The first of these factors is ownership; public companies are typically owned by a large number of shareholders whose primary interest in ownership is economic. However, family businesses are often owned by a much smaller group whose ownership often has elements of personal identity, family legacy, and community responsibility entwined with its economic interests. This "emotional ownership" often results in family businesses having a longer-term view. Management of a public company is focused on the next quarter's results and the impact they will have on the share price, whereas a family business can focus on what is best for the business and the family in the longer term, knowing that it is extremely unlikely that any of the family will want to sell their shares if the business has an off quarter.

Another factor that tends to separate successful family firms from their public counterparts is the concept of stewardship.

<sup>1</sup> *Generation to Generation: Life Cycles of the Family Business*. Gersick, Davis, Hampton & Lansberg. Harvard University Press, 1977.

Many family businesses have a clear understanding that the business is something to be preserved and grown for future generations. As Bill Ford, the Chairman of Ford Motor Company once said, "I'm working for my children and grandchildren and feel I'm working for our employees' children and grandchildren as well."

This longer-term focus and emphasis on stewardship often results in family businesses outperforming publicly-owned businesses in terms of profitability and innovation. As summarized in *MSN Money*, July 28, 2004,<sup>2</sup> Professors David Reeb and Ronald

Anderson have identified that, "Whether your yardstick is some accounting measure like return on assets or stock-price performance, family-run companies outperform the rest by anywhere from 6 percent to 13 percent. On average, across all measures, they beat other companies by 10 percent."

Key to effective governance for a family business is recognizing when the family business is moving from one stage to another, and designing revisions to the governance structure that will meet its needs for the next stage.

STAGE	CHARACTERISTICS	GOVERNANCE
<b>Controlling Owner</b>	<ul style="list-style-type: none"> <li>– Founders own and work in the business</li> </ul>	<ul style="list-style-type: none"> <li>– Inactive Board of Directors (decisions rest with a small group)</li> <li>– Advisers</li> </ul>
<b>Sibling Partnership</b>	<ul style="list-style-type: none"> <li>– Siblings have an ownership interest</li> <li>– Some family shareholders not working in the business</li> </ul>	<ul style="list-style-type: none"> <li>– Active Board of Directors</li> <li>– Advisers</li> <li>– Family Council</li> </ul>
<b>Cousin Consortium</b>	<ul style="list-style-type: none"> <li>– Diverse family ownership</li> <li>– Some management not part of family</li> </ul>	<ul style="list-style-type: none"> <li>– Active Board of Directors</li> <li>– Family Council</li> <li>– Shareholder Rights and Responsibilities Committee</li> <li>– Continuity plan</li> <li>– Management Development plan</li> <li>– Family plan</li> </ul>



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<sup>2</sup> Michael Brush, "Family-size returns, without the drama" *MSN Money*, July 28, 2004.

# A Family Business *Risk Management Strategy*

Make Family *Communications* a Top Risk Management Strategy

**Grant Walsh**, Co-Founder and Director, KPMG Enterprise Centre for Family Business

The current economic climate is forcing business owners to pay closer attention to major risk factors (such as global recession, currency fluctuations, tight credit, and declining consumer confidence) that can negatively impact the company's performance. Unfortunately, most of these risk factors are out of their control. However, there is one major risk factor that family businesses CAN control—"communications."

Although we tend not to equate "communications" directly with "risk management," in a family business, it still remains one of the major impediments to enhancing the numerous benefits that the family component can bring to the table.

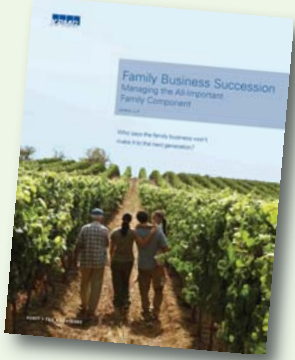
*"It seems surprising in the age of Oprah and Springer, where people will spill the intimate details of their lives on national television, to find that communication is still a major impediment to harmony and balance for many business families ... Whatever the reason, that 1960's cliché, 'a failure to communicate,' is probably the biggest stumbling block family businesses face."*

*(Lynch, A., All in the Family Inc.)*

Over the years, family businesses have done a good job at mitigating market risks. According to the research, major contributing factors are their willingness to focus on the longer term and their ability to draw upon the family, including the broader family members, to help them navigate through tough times. In effect, it is generally agreed that a major

competitive advantage family businesses have over their non-family business counterparts, is the family component. However, this competitive advantage can quickly turn into a disadvantage if not properly managed. The single biggest challenge in managing the family component is effective communications, a risk factor over which the family business owner has total control.

The importance of effective communications among family members is even more significant when the family business is contemplating transitioning the business to the next generation. Succession in itself is risky enough without having to further compound the risks with ineffective communications. As a result of ongoing research and experience gained from family business practitioners, a number of proven family business communication strategies have emerged to help family businesses effectively manage their family component. Family businesses who have applied these customized communication strategies tend to dominate their markets and continue for many generations.



Complimentary Download  
How-to-Strategies for family business  
succession planning

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## Three Components to an Effective Family Business Communication Strategy

### 1

#### Family Business Meetings

Let's start with the "Family Business Meetings," since they are the most important. The purpose of Family Business Meetings is to provide the active family members with a dedicated communication forum to discuss family issues that can impact the business, and business issues that can impact the family. In many cases, the discussion will revolve around management and ownership issues. These are the kind of issues that pertain to the management of the all-important "family component" referred to earlier. Unlike a "Family Council," which is addressed below, whose members include the broader family, the Family Business Meetings are comprised only of family members who are active in the business. Once the Family Business Meetings have proven their effectiveness at addressing the family and business issues, holding Family Council meetings (i.e. broader family) would be a logical next step.

Family Business Meetings are not intended to replace regular business/management meetings or meetings of the Board of Directors (even if they involve the same players). Family Business Meetings are dedicated meetings for family members who are working in the business. These meetings are used to deal with the interaction between the family and the business (the family component) as it relates to the management and ownership of the family business. The agenda for any given meeting can be primarily business issues, primarily family issues, or both. What's important is to have them.

Engaging the services of a family business practitioner to facilitate the Family Business Meetings is highly recommended.



### 2

#### Family Council Meetings

The purpose of a Family Council is to provide a communication forum that allows all the family (direct and indirect, active and non-active family members) to learn more about the family business and to provide them with an opportunity to express their views on family issues that impact the business, as well as business issues that impact the family. Family Councils are typically comprised of the broader family, which can include spouses, in-laws, children, grandparents, and grandchildren, whether active or non-active in the family business. Given the potential size and composition of the Family Council, these meetings are typically held annually or every couple of years, unless the business is in succession/transfer mode, where these meetings may be required more frequently. The meetings are most effective when they focus on keeping family members informed of the "big picture." They are not intended to be used as a decision-making forum for day-to-day business issues or a decision-making forum for management and ownership issues. They are intended to inform, educate, and obtain feedback from the broader family on specific issues.

### 3

#### Family Business Rules

*So what does the outcome of all these family meetings look like?*

As a result of the family business meetings, the active family members will have heard the views and opinions of the other active family members, especially those of the current owners with respect to the management and ownership of the business. One of the key outcomes of these meetings is that the family business will now have developed/endorsed a number of management and ownership guiding principles or rules to help direct and guide the behaviour of family members in their day-to-day business activities. All of this will provide the active family members with a better understanding of what is expected of them so that they can make informed decisions about their individual and collective roles in the future management and ownership of the family business. These guiding principles or rules are often referred to as the "Family Business Rules."

### Our Family Business Rules

As one parent put it:

*"These are the rules of the game—our constitution, so to speak—with background information to help you understand why we came up with the rules we did. It will be up to you to review what we have done, and when the time comes, to revise the rules to fit the needs of the family and the business in your generation."*

*Developing Family Business Policies – Family Business Leadership Series*

That was one of the best gifts that they could ever have given their children.

Developing agreed-upon rules and abiding by them can help reduce the chance of having to deal with conflict that will no doubt challenge personal relationships, business relationships, and, therefore, the family business. To help mitigate or eliminate this risk factor, make family communications one of your key risk management strategies. In doing so, you can benefit from the advantages that will accrue from managing your family component. Unlike many other risk factors your business is facing, this one can be in your total control.

The following table lists items that are often found in Family Business Rules. These are all “family component” type issues within a family business.

## Family Business Rules

General Issues	Management Issues	Ownership Issues
<ul style="list-style-type: none"> <li>• Rationale for having a set of “Family Business Rules</li> <li>• Conflict resolution process (family disagreements).</li> </ul>	<ul style="list-style-type: none"> <li>• Timeline for the management succession</li> <li>• Communications to family, managers, and employees</li> <li>• Employment of family members (criteria)</li> <li>• Employment of spouses and in-laws (criteria)</li> <li>• Compensation philosophy/approach for family members</li> <li>• Grooming/training the management successors</li> <li>• Performance reviews for family members</li> <li>• Role of current owners during and after the management succession</li> <li>• Leadership (e.g. co-leadership, management team)</li> <li>• Role of non-family employees in senior management</li> <li>• Leave of absence and sabbatical by family members</li> <li>• Conflict resolution process (resolving management succession issues among active family members).</li> </ul>	<ul style="list-style-type: none"> <li>• Timeline for the ownership succession</li> <li>• Communications to family, managers, and employees</li> <li>• Who can own shares (active, non-active, direct, indirect family members) and why?</li> <li>• How will the shares be acquired? (method and funding)</li> <li>• Will the ownership transfer be gradual/partial or all at once?</li> <li>• Does the ownership succession support the management succession?</li> <li>• Role of current owners during and after the ownership succession?</li> <li>• Compensation for the owners (salary, bonuses, annual distributions)</li> <li>• Exit strategy (fair and equitable)</li> <li>• Minority shareholders (expectations and how to manage them)</li> <li>• Role of non-family employees in ownership</li> <li>• Nuptial and pre-nuptial agreements for future owners</li> <li>• Loans to family members (terms and conditions)</li> <li>• Public relations (who speaks for the family business?)</li> <li>• Philanthropy and community activities (which ones? how much?)</li> <li>• Conflict of interest for family members (guidelines)</li> <li>• Shareholders agreement that reflects/supports the succession objectives</li> <li>• Conflict resolution process (resolving ownership succession issues among family members).</li> </ul>



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# *Gift*ing *Ownership to the* **Next Generation**

**Brad Klassen, FCA, Partner, KPMG Enterprise**

Everyone is acutely aware of the challenges that beset a family business after the founder leaves. While the transfer of any family business to next generation can be complex and time consuming, it can help to be proactive and plan ahead for the transition.

Understandably, there are several reasons for proactively transferring or gifting the business to the next generation:

- Ensure ongoing profitability and management of the business to provide for ongoing financial needs of the family and employees
- Motivating the next generation
- Providing some certainty with respect to ownership
- Estate planning for the parents, including tax management and distribution of wealth
- Utilization of tax incentives, such as the capital gains exemption.

Techniques for the transfer of shares are as well known:

- Estate freeze, where shares exchanged for fixed value shares and

new common shares are issued to the family members

- Gifting the shares to the next generation
- Selling the shares to the children.

Whichever technique is used is unique to every circumstance and depends upon many factors, including the tax result or whether you want or need cash on the transaction. The timing is also a very important consideration.

The other aspect of transferring the business to the next generation is actually handing over the day-to-day decision making and leadership of the company. In most cases, the parent continues to have influence in the family affairs, which include the business and ownership structure. Sometimes this influence is a positive and healthy one, but sometimes it might not be so positive.

In one situation, the freeze and redemptions occurred, but, unfortunately, one of the parents became ill and began challenging decisions that had been made decades ago. In another situation, which is all too common, advanced planning was done, but it relied on the death of the parent to be implemented. When the family situation changed, the spouse attempted to unravel much of what had been set in motion.

Scenarios like these occur despite applying all of the standard estate planning/succession planning/ownership restructuring techniques available. Shares were frozen and even redeemed, family meetings occurred, everyone knew their role, and the parents' Wills allocated the assets on a fair and equitable basis to the children.

It goes without saying that even with the best laid plan, you cannot take the family out of family business—even with a shareholder agreement, pre-nuptial agreements, and signed Wills in place. Another great take-away is that not discussing transition strategies in advance and completing the planning can make it much worse.

Working with family businesses is memorable more so because of non-technical aspects than the technical. Working to help families resolve such issues and build successful businesses is gratifying. In both cases shared, the families became fragmented and recovery is taking a long time.



#### A well thought out and implemented plan can go off the rails for different reasons:

- Health of the parent
- Sibling relationships
- New parental relationships, such as a new spouse
- Business issues.

#### Can you plan for every contingency? The answer is no.

#### Are there things you can do to help alleviate issues in the future? The answer is yes.

1. Seek assistance from professionals
2. Go through a proper succession planning process with open communication

3. Investigate and thoroughly understand the techniques that are available
4. Document not only the specific transactions, but the reason behind specific transactions
5. Plan the buyout of the parents
6. Plan the ongoing involvement of parents.

Obviously, one cannot control or think of every possible situation. Providing for a mechanism to deal with issues is as important as building flexibility into the plan. When it comes to the business, you have to make decisions that are in the best interests of the its success—even if at times it means the family comes second.



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# The Third-Party Sale

**Tom Zurowski, CA, Partner, KPMG Enterprise**

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The succession process is meant to find out if family members wish to continue the legacy into the future. However, in some cases, this may not be possible for any number of reasons, which leads to the need to sell the business to someone outside the family.

The non-family buyers could be employees, competitors, or other parties wishing to enter the industry or market. The employee buyout is discussed in another article, so here we will focus on selling to other businesses.

The first challenge is finding the buyers, which is not that easy, since there is no organized market for businesses like there is for real estate. Therefore, you may need to do some searching to identify possible purchasers and then plan to approach them about a potential sale. In some cases, completely unexpectedly, you may have someone show up wishing to buy your business, so you want to be ready when this opportunity arises.

The second challenge is to always be prepared for a sale at any time. You should make sure any necessary housekeeping is done, because you do not want to be undertaking significant restructuring of

your business at the same time as you are trying to sell it.

The third challenge is knowing your price; you need should have a reasonable price in mind at which you would be willing to sell the business. Having a price in mind that is far too high may stop negotiations for sale before they even get started. Having a price that is too low means you may not realize as much as you should for all of the efforts you have put into growing the business. The goal is to optimize the selling price, which sounds quite different from maximizing the selling price. The difference between maximizing and optimizing the price is keeping in mind that the amount that matters is what you have left after tax in your bank account. So, proper tax planning can help you keep the price marketable so that the buyer is willing to purchase, but at the same time help you end up with as much cash as possible.



In some cases, you cannot just come to an agreement on the price since you think the future prospects of the business are very good, because the buyer may not share that same optimism. To solve the impasse, which can end a deal, you may need to be prepared to accept an “earn out,” where you receive a certain agreed-upon base price and, if the future earnings are strong enough, you may be entitled to further proceeds. Careful tax planning with an earn out is important to: (i) minimize the income taxes that are paid and (ii) match the timing of future sale proceeds you receive to when you need cash to pay the income taxes.

The fourth challenge is to do proper and timely tax planning. Most tax planning aims to permit the use of the \$750,000 lifetime capital gains exemption, as this is a “tax-free” sale (please note the use of the term “tax-free,” as we do not get to use it very often). Like anything that is good, however, there are many restrictions

on the use of this exemption, so, long before any sale discussions start, you need to review your ability to use your capital gains exemption and possibly the capital gains exemptions of your family members (multiplying the use of the exemption with other family members can certainly leave much more cash in your hands). If, for any reason, you cannot use the capital gains exemption, there is still other tax planning that can help reduce the income taxes on sale.

The fifth challenge may actually be retiring. Once the sale is completed, you may think it is time to go golfing, fishing, or travelling, but, in many cases, this does not happen. Since you built the business, the new owner needs your expertise to be transferred to them so they can operate it profitably. Usually, you will be asked to stay on for a period of time (1 to 3 years, depending on the business) to make the transition smooth. If you do not stay on, then the buyer may not be interested in the deal.

The last challenge is to plan past the sale. Once you have your cash in hand, you need to decide how to manage the investments to provide for your future lifestyle. This may take you some time, as you may also need to adjust to the new lifestyle.

This may seem like too daunting and too large of a task to even embark on the journey. So what “secrets” do you need to help you along the way? Make sure you start planning early so you can consider options, and be flexible enough to be ready for the sale. Get good professional advisers who have been on this journey and can help you along the way. Be patient, as this may take time to accomplish, and jumping at the first offer that comes along may not be the best answer. A negotiation position shrinks very fast if you are too anxious to make that sale.



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# ***Sale*** of Business to ***Employees***

**Sarah Tkachuk, CA**, Senior Manager, KPMG Enterprise

In the next few years, many businesses will transition to a different owner. In many cases, business owners have looked to their family members to take over the business. Where that is not an option, entrepreneurs often look to other avenues. A sale to employees is often an attractive option.

## ***The benefits of selling to your employees include:***

- They often share the entrepreneur's vision and passion for the business. They have often been involved in the business for a long time and understand the strengths, weaknesses, and opportunities in the business and market
- The entrepreneur usually has trust and confidence in their employees. They have had an opportunity to observe their management skills and mentor their development over the years. They are comfortable that their "baby" will be in good hands
- The other employees know and trust the successors. There is less fear of change and an opportunity to make a smooth transition.

## ***That does not mean that this type of sale is without drawbacks. Some difficulties in this type of sale typically are:***

- There is a lack of cash flow and ability to finance the purchase. Most employees do not have the cash flow or credit necessary to fund a straight buyout. In many cases, the entrepreneur ends up financing the sale
- There may be potential conflict within the organization if other employees feel that they have been passed over or if they do not accept the successor. This can lead to internal power struggles and turnover, which can be detrimental to the business
- The successor's leadership and management skills may require development. What makes a good employee does not always make a good leader.

Typically, the scenario where the vendor takes a big cheque, packs their bags, and heads off to foreign sunny beaches is not realistic in the sale to employees. Therefore, it requires a little more flexibility to facilitate an employee sale. For many people, this is a reasonable trade-off for the control that they have over grooming the next owner. These options can be tax effective if structured properly, so it is critical to involve your advisers in the planning. Some sale structure options are as follows:

## 1 The business finances the sale

Through the use of a holding company, the future owners can purchase the assets or shares of the company from the vendor. The new owners can then use inter-corporate dividends from the coffers of the business to repay the previous owner. This typically would involve leveraging the business to fund the buyout.

## 2 The owner finances the sale

In some cases, the vendor is willing to accept a delay in receipt of the proceeds of the sale, and future cash flows from the business will finance the buyout. Where the proceeds of the sale are deferred, there is an opportunity to defer a portion of the tax on any capital gains over 5 years, or until the proceeds are repaid. This may make this option attractive to the vendor. The vendor often requires the employee put up enough of their own money to ensure their vested interest in the business. If the business is financed with third-party debt, it may leave limited security for the vendor financing. In this situation, the vendor will place more importance on getting their cash as soon as possible. The vendor may choose to retain some form of voting or veto control until they have been repaid.

## 3 A third party finances the sale

The employees may be able to bring a third party, such as a venture capital fund, to the table. An employee purchase may be attractive to third parties because of the knowledge and experience that they bring to the table.

*The key to a smooth transition is communication, and an important part of the process is negotiating a shareholders' agreement, which is a rule book that will govern the relationship going forward. It can often prevent or resolve disputes, and is critical for setting the stage for communication going forward.*

*It is important to remember that what makes a good employee does not always make a good owner. The employee may need additional training and development to take their leadership skills to the next level. Your advisers can help you develop a plan to develop the future leaders. This process can take some time, as the employees need to learn how to think of the business in a different light, and may need to learn new concepts around corporate structures, financing, taxation, and managing the business from a different level. Starting to think about these issues when you are ready to retire is too late.*



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# Engaging the *NXT* Generation

## For Successors Only ...

**Sylvain Darche**, Coach, Darche Solution Relève Inc.

For successors, giving oneself a development plan can be a crucial part of their success in their future role. Here are a few pointers.

The challenges facing successors are tremendous because they are called to guide a company that has probably progressed, and changed, throughout the years. Let's consider different aspects because of this situation.

The training and academic studies represent important aspects that need to be aligned with the needs of the company. Above and beyond these aspects, successors that succeed have a good working knowledge of the different departments in the business and of the industry and the competition in general. They also have good management skills and have strategies to develop their company. Another extremely important aspect to consider is to adopt a positive attitude that includes good humour and openness toward others. Over the last 10 years in the field, I have noted successors who have a positive attitude towards life and the future; during daily relations with the boss, colleagues, staff members, family, customers, along with suppliers, having an attitude of collaboration, openness, and proactivity is essential.

### Active collaboration

Successors who have success build their credibility by following up on demands and prioritizing within the allowed framework, and also by the way they communicate with their superiors and customers when the work is done.

They treat members of their family (father, sisters, brothers, cousins, uncles, etc.) with the same respect deserved by their customers.

Successors that perform well surround themselves with a solid internal team; also, they put together a committee of consultants who challenge and support them as necessary. They take over with finesse and leave room for others.

### Showing openness

Successors who are top performers take an active role in the management committee and consulting committee. They accept that their style may be challenged and adapt their approach to projects from the feedback they receive. They find importance in the comments and criticisms without losing confidence in themselves.

They make sure to play the role that corresponds to their position in the business without taking for granted their family tie (this last aspect is not without major problems).

### Being proactive

They make sure to know the rules that apply to the family members: internal rules, salary, promotion process, managing conflicts, etc. They are predictable and clear so that everybody adequately prepares themselves, and they stay away from improvising. When they put forth improvement or investment projects, they make sure they are well researched, that they cover all aspects, and that they are ready to answer questions and adapt. These projects are presented at the proper time and to the proper people, but not at family events or gathering events, nor between two meetings.

They work more than 40 hours per week at the job and are efficient at time management. Their positive attitude towards staff and family members contributes towards constructive exchange.

Also, they make good use of advisers who have extended business experience and believe in their potential.

*Now ... what is your development plan for 2010?*



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## Viewpoint from a Successor

**Hélène Picard**, Vice President, Areo-Fire Ltd.



**Taking on the leadership responsibility of a family business brings multiple concerns when you are the successor.**

When it comes to the example of Areo-Fire, my first concern is to satisfy the owner's expectations, who happens to be my father, by getting his continuous confidence. I would like him to know that by my daily actions, I am totally devoted to the company's success and to properly organizing services provided to our customers. The aim of my actions is to maintain and increase the company's annual turnover. Also, I am trying to gauge the market uncertainty and develop concrete and achievable action plans with the team.

Even though I am only 38 years old, I think it is important for me to start preparing the next generation. They too are young, and introducing them to different situations by way of development programs, through sports or other means, hones their leadership and awareness towards commitments and money matters.

As some members of our staff will retire within 4 years, we should anticipate a plan using twinning stages, with a gradual integration to succession.

### *Areo-Fire Ltd.*

*The mission of Areo-Fire Ltd. is to become the primary supplier of quality fire-fighting and fire-protection services and equipment for Eastern Canada's municipalities, industry, and government agencies. This will be achieved through inventory maintenance, expansion, and empowering the members of our team, in order to preserve the profitability that will support our growth.*

**For more information about Areo-Fire Ltd., visit [www.areo-feu.com](http://www.areo-feu.com).**

The consulting committee provides outsider advice that enhances our experiences and challenges us on important matters. Since we are busy with the daily operations, our trusted advisers help us with their follow up and by keeping the focus on the business's strategic plan. I am looking forward to their continuing involvement in upcoming growth projects for Areo-Fire.

## Hot Tax Topics to Consider in a Family Business Transfer

**Daniel Gosselin**, Partner, KPMG Enterprise

In order to have a successful family business transfer, a few basic items should be considered. For example, who will eventually take command of the business and which actions will be taken to defer the tax payments for as long as possible? The following points will highlight some important tax issues to consider in a family business transfer.

### Trust, a useful tool

Setting up a family trust several years before retiring from the company is part of a successful family business transfer. At the time of the set-up, there is no need for the parents to know in advance which children will be active members of the company, since the trust should be a discretionary one. Being a discretionary trust, the trustees

(probably the parents) have the power to determine which beneficiaries will receive payments from the trust and when.

Children or other family members could be named as beneficiaries of the trust and eventually be able to benefit from the capital gain exemption at the time of the disposal of the shares. The trust will also be useful to perform estate freezes and help reduce the taxation at time of death. At the time of the estate freeze, the value of the company will shift from common shares to frozen shares and all the future increases in value of the company will be attributable to the newly issued common shares and could be given to the children involved in the company.

### Who is going to pay the tax bill?

A family business transfer between generations can have important tax impacts, and having good tax planning can help reduce those impacts. Most of the time, the difficulty in a family business transfer is that the children do not have enough liquidities available at the time of transfer to afford the purchase price.

In some situations, which are not ideal, the capital gain of the parents will be offset by the capital gain exemption, and the children will have to finance the transaction. In order to be able to overcome that hurdle and be able to pay their parents, children could receive dividends or salaries from the corporation, pay taxes on these revenues (at the highest tax rates), and use the money remaining to pay the purchase price to the parents.

In other instances, when parents do not need the money immediately, their shares could be transferred to a Holding company and the purchase price of those shares could be paid to that company. In that situation, parents often don't personally need the cash right away and could defer the withdrawal of funds from the corporation after several years, so it could be possible for them to keep that money in

a Holding company until they need it. The taxation could therefore be deferred until they need the money personally. At this point, the parents could receive dividends from the Holding company.

Another option could be that the parents sell their shares to the children and realize a capital gain without claiming the capital gain exemption. The parents could claim, if all conditions are met, a reserve until 10 years if their right to receive the purchase price is not before the end of each year. In this situation, the parents will pay tax on a capital gain and not on a dividend, so the taxes will be lower.

### When is the right time to transfer control over?

An appropriate moment to transfer over the control of a company could be when a considerable portion of the purchase price has been paid by the family member. The Will and the shareholders' agreement need to anticipate who is going to have the control in case of disability or death.

### Establishment of the modality of the frozen shares redemption

A clear redemption plan should be determined at the time of the transfer in order to ensure that the parents get the same consideration as any other third party creditors, and that the children will be the owners one day.

### Utilization of the capital gain exemption

The capital gain exemption of \$750,000 is available to the individual that sells "qualified small business corporation shares." In order for the shares to qualify, the individual must, amongst other things, ensure that the corporation is a Canadian-controlled private corporation using more than 90 percent of the fair market value of its assets in an active business carried on primarily in Canada at the time of the transaction, and, similarly, for the 2-year period preceding the disposition, that more than 50 percent of the corporation's assets were used in

carrying on a business in Canada. To be eligible for the exemption, it is important to continually purify the corporation and avoid maintaining assets in the corporation that could disqualify the shares. For example, shares of non-resident subsidiaries, excess of cash, investments, etc.

### Will, shareholder agreement, and family trust deed ... all together towards a same goal

You should have a Will that fits the shareholder agreement and the family trust deed, in order to avoid problems at time of transfer or when the parents will die.

### Split of the assets in the Will

In order to be fair with each family member, the parents need to determine how the assets will be split between the family members participating in the business and the other family members whose wishes are not to be involved. Those wishes and the income tax consequences should be foreseen in the Will.

### Life insurance

Life insurance is an important tool in business succession planning; its proceeds are not taxable, even though they are received by a corporation. If the insurance is received by an individual, the insurance benefits that will be received at the time of death could help to pay the taxes of the deceased (his estate). If the insurance is received by the corporation, the income taxes of the deceased could be lowered due to the fact that the capital gain on the shares disposal could be reduced, due to the capital dividend account (CDA). Finally, the company will be able to declare non-taxable dividends to its shareholders.



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