



KPMG ENTERPRISE

Integrated Tax Planning Is an Important Component of any Successful Exit

KPMG ENTERPRISE



KPMG Enterprise
Centre for Family Business

Proactive tax planning can do more than just save tax

You've spent years working hard to build a successful business and you want it to stay in the family. Even if you're not ready to pass the torch to the next generation, start planning now to help ensure a smooth transition down the road and avoid the many pitfalls along the way. It's estimated that 70 percent of family businesses will not survive into the second generation. To keep your family business among the 30 percent that do survive to future generations, it's vital to plan ahead.

Why do so many successful business people fail at the essential task of planning to pass on their businesses to the next generation?

The reasons may include fear of losing control of the business, unwillingness to invest in developing a succession and estate plan, or difficulty in choosing a successor, which can naturally be complicated, especially when family members are involved. As a result, many business owners adopt a wait-and-see attitude or simply tell themselves that everything will fall into place naturally.

Allowing these or other reasons to prevent you from making a succession plan until you are ready to retire can be disastrous. For example, an untimely illness may leave the business without a leader before others are prepared to step up. As such, most professional advisers agree that you should plan for a 3 to 5 year transition phase to allow your successors to build the skills and acquire the experience they will need to run the business.

Common considerations in succession planning

Based on the practical experience KPMG Enterprise professionals have gained from years of advising family businesses on succession activities, here are a couple of examples of common issues to consider when planning for an effective family business succession:

- Make an effort to understand the philosophy of the next generation of family members whose ideas and visions for the business may be different from yours. If you impose your views on family members who are active in the business without listening to theirs, it may lead to distrust and misunderstanding and a more difficult transition.
- Consider how to fairly compensate each family member for their role in the business. For example, a family member may be an owner but not part of the management team or another family member may be part of the management team but not an owner of the business. As the involvement of each family member in the business may vary, consider rewarding family members in accordance with their contributions to the business.



Tax considerations in succession planning

When you're ready to start succession planning, keep in mind the benefits of making tax considerations an integral component of your plan. Tax planning can not only help reduce taxes in your business succession, but can also allow you to retain control of your company during the transition period, while at the same time providing you with the flexibility to decide which family members will receive what share of the family business and when. These plans generally involve the implementation of an "estate freeze" and the use of a family trust.

What is an estate freeze?

In a typical estate freeze, the common or equity shares that the parent owns in a family company are valued at the current fair market value. The parent exchanges his or her common shares, which grow in value as the company grows in value, for preferred shares that have a fixed value equal to the fair market value of the common share at that time and do not participate in the future growth. Other family members or a family trust may then subscribe from treasury for new common shares that will participate in the future growth. The parent may wish to participate in the future growth as well and therefore could also subscribe for some new common shares or possibly be a beneficiary of the family trust. Careful tax planning is required if the parent is also a beneficiary of the family trust. If there is a capital gain in the existing common shares, the parent may elect to crystallize the portion of capital gain equal to his or her available capital gains exemption.

An estate freeze can allow you to pass on the future growth of the business to the next generation on a tax-effective basis while retaining control of your business—an important option. Dynamics can change in a family—as the "freezor," you may wish to keep control of your business until you fully retire.

What is a family trust?

A trust is a legal relationship that has three key participants: the settlor, the trustee and the beneficiaries. The settlor creates the trust by means of a trust deed by settling cash or other property (called the "capital" of the trust) on the trust.

The trustee manages and administers trust property on behalf of the beneficiaries in accordance with the terms set out in the trust deed.

The beneficiaries receive the income and/or capital of the trust. There are two types of beneficiaries: "income beneficiaries," who receive allocations of income earned by the trust, and "capital beneficiaries," who receive distributions of trust capital.

Frequently, in a family trust, the settlor is a grandparent, the trustees are the parents and an arm's length person, and the beneficiaries are the children. Where such a family trust subscribes for new common shares in an estate freeze, the common shares will remain in the trust and will not be directly owned by the children. The children are trust beneficiaries and do not have entitlement to the shares until the shares are distributed to them. With a "discretionary trust," the trustees exercise discretionary powers as to who gets what and when, which applies to both income allocations and capital distributions. For example, the trustees may decide to

allocate more income to a particular beneficiary in any particular taxation year of the trust, or distribute more shares to a particular beneficiary on the winding-up of the trust, as long as they fulfill their fiduciary obligations and deal with all the beneficiaries with an even hand.

In general, every 21 years a family trust is deemed from the date of creation to dispose of all of its property at fair market value. Accordingly, any accrued capital gains are taxed at that time as if the assets have been sold. Consequently, prior to the 21st anniversary of a trust's creation, it is a good idea to consider consulting a professional adviser to determine what steps can be taken to help minimize the impact of a deemed disposition of all of a trust's capital property.

In summary, using a discretionary family trust to own the new common shares in an estate freeze can help ensure flexibility in succession planning. In addition, future growth of the company can accrue to a pre-defined class of beneficiaries, even though at this stage you may not have decided which particular beneficiary will inherit the business.

Conclusion

As is evident from this brief outline of some of the issues and methods of completing a successful succession of your business, it is advisable for any family business owner to plan ahead and start the succession process well in advance. In many cases, the shares of the family business represent a significant asset of the family; therefore, careful planning is required to help ensure the value is maintained and increased throughout the succession process.



How we can help

KPMG Enterprise professionals offer a wide range of business and personal tax services, including advice on using estate planning and family trusts to help reduce your family's tax burden now and leave as much as possible to your heirs. Your KPMG Enterprise adviser can help you determine which estate and trust planning options are best suited to your circumstances and how you can integrate your tax planning with your overall estate plan.

In addition to providing Accounting, Audit, Tax and Advisory services, we offer a range of services geared to the needs and dynamics of the family business:

- Transition planning, equity transfers and generational change
- Family business governance, including family councils, family constitutions, board structures, business decision making and assurance frameworks
- Strategic business planning
- Tax planning and compliance, including HST, capital gains tax and income tax
- Wealth creation planning and wealth preservation
- Asset protection
- Retirement planning, estate planning
- Sale and purchase of family businesses.

Why select us

It makes sense to work with advisers who really understand how a family business operates. Having worked with family businesses for decades, KPMG Enterprise has the experience and know-how to help you achieve your business objectives and family goals.

Value for money

KPMG Enterprise professionals seek to deliver value to their client beyond the fee

charged. Our experienced family business professionals isolate the key issues quickly and efficiently. It means you're not paying for someone to learn on the job.

Industry knowledge

Our understanding of family business issues is reinforced by our in-depth industry experience across all business sectors, including manufacturing, automotive, transportation, retailing, food services, franchising, property and construction, communications and technology, and hospitality.

Culture and values

You want business advice that is relevant, timely and, most importantly, objective and independent. KPMG Enterprise values integrity and independence above all else. We set out to build long-term relationships with our clients built upon mutual respect and trust.

People

Our experienced professional advisers combine strong technical capabilities with deep business insight and experience. They're proactive in raising ideas and know the importance of getting results in a timely, no-fuss manner.

Multi-disciplinary approach

Our family business clients can draw on our firm's extensive capabilities across a range of professional disciplines. We've also forged alliances with academics, family business facilitators, lawyers, financial planners and business mentors. These resources can be "mixed and matched" to meet the specific needs of your business. It's an approach that can help avoid the expense and overlap of working with multiple advisers.

Clear, actionable advice

We know our clients don't have the time to wade through advice that is vague and impenetrable. Our advice is practical, jargon-free, relevant and timely.

We work with family business clients to simplify complexity and isolate the key business issues.

About KPMG Enterprise

With decades of experience working with family businesses across the country and with many KPMG Enterprise advisers coming from family businesses themselves, we understand that the nature of a family business is inherently different from a non-family business. That's why we pulled together a unique team of professionals within our firm and developed an equally unique portfolio of services that address the specific needs of Canadian family businesses and their owners.

About The Centre for Family Business Brought to you by KPMG Enterprise

KPMG Enterprise's Centre for Family Business is dedicated to assisting family owned and operated businesses to effectively deal with their unique management challenges. Our goal is to help guide family businesses in their day-to-day operations with a focus on the continuity of the family business. It includes an open virtual forum where members of any family business can share experiences, gain insight into leading practices and obtain the essential support to grow and thrive in today's competitive economy. Visit kpmg.ca/centre-for-family-business.

Contact us

For more information regarding the Audit, Tax and Advisory services offered by KPMG Enterprise, visit our website at kpmg.ca/enterprise or contact:

Beverly J. Johnson, Partner
National Chair, Centre for Family Business
KPMG Enterprise (Saskatoon)
T: 306 934 6223
E: bevjohnson@kpmg.ca

British Columbia
Mike Fahrmann, Partner
T: 604 691 3141
E: mfahrmann@kpmg.ca

Kelly Watson, Associate Partner
T: 250 979 7179
E: kellywatson@kpmg.ca

Alberta
Dean Gallimore, Partner
T: 403 380 5714
E: deangallimore@kpmg.ca

Saskatchewan
Sarah Tkachuk, Senior Manager
T: 306 791 1223
E: stkachuk@kpmg.ca

Manitoba
Norm Woltmann, Senior Manager
T: 204 957 1770
E: nwoltmann@kpmg.ca

Peter Miller, Partner
T: 204 957 2294
E: pmiller1@kpmg.ca

Ontario
Roger Bryan, Associate Partner
T: 519 251 3501
E: rogerbryan@kpmg.ca

Ruth Todd, Partner
T: 905 687 3287
E: retodd@kpmg.ca

Perry Muhlbier, Associate Partner
T: 416 224 4119
E: pmuhlbier@kpmg.ca

Grant Walsh, Senior Manager
T: 613 212 5764
E: grantwalsh@kpmg.ca

Quebec
Daniel Gosselin, Partner
T: 514 840 2490
E: dgosselin@kpmg.ca

Atlantic Canada
Gordon Moore, Partner
T: 902 492 6032
E: gdmoores@kpmg.ca

Luann Jones-Foster, Associate Partner
T: 506 856 6477
E: ljonesfoster@kpmg.ca

Special Advisers:
Don Zinyk, Special Adviser,
KPMG Enterprise Centre for
Family Business
T: 780 434 4318
E: dazinyk@shaw.ca

Bill Corbett, Special Adviser,
KPMG Enterprise Centre for
Family Business
T: 250-860-9786
E: corbettca@shaw.ca