

The Family Business “Should I Stay or Should I Go”

A great number of Canadians have benefitted from the family business in one way or another. This benefit may simply be as a dependant of a parent, or other family member, who has created and successfully developed an owner managed business. It may also be as an active owner/manager putting in long hours and creating a viable entity. Invariably the time will come when a decision must be made on future involvement.

The need for this decision may come at a time when a parent wishes his/her child to take over the business. In this situation the child must decide if they have the same level of interest in the business and if they have the characteristics to continue in the capacity of their parent. Alternatively the child may indicate their desire to take over the family business. This may be a very difficult time for the parent as they are forced to critically evaluate their child’s ability to carry on and ensure the entity’s success in the future.

Statistically, the more likely scenario will arrive at retirement time when the owner/manager must decide how best to dispose of his/her lifelong asset to a third party. In each instance it is important to have a well thought out and timely plan.

In the event that a family member is being considered to carry on the business, a number of issues need to be addressed. For instance, in a parent-to-child transfer it may be necessary to ensure other children are dealt with in a fair and reasonable manner with respect to the parent’s estate. Furthermore, it is essential that the child critically evaluate



their ability to perform in the role being vacated. The child needs to ask him/herself “would I choose this opportunity if it were not my mother/father’s business and, do I have the same passion for this business as my parent?”.

No matter how it unfolds, an exit plan is absolutely necessary. It is just as important as your original plan was when you started the business. The good news is, given enough lead time, a plan can be developed that will ensure you are adequately compensated on a sale or transfer of your business.



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Increasing the Value of Your Business



Will your company continue to make money when you're gone? It's a humbling question, but one that all business owners need to ask themselves. One day you will face the challenge of leaving your business and if you plan on selling it, the answer to this question must be yes.

The demand of owning and managing a business forces many entrepreneurs to be profit-driven. Certainly, profits are important, but value isn't built on profits alone. This helps explain why every year thousands of lucrative businesses either sell at a fraction of their anticipated value or don't get sold at all.

Profits are the product of past success, but potential buyers are interested in the future. They seek companies that have the potential for long-term growth and can easily undergo a change in ownership. Value, in other words, depends on sustainability and transferability.

In simple terms, sustainability refers to a company's ability to maintain its performance over an extended period of time. Transferability refers to a company's ability to maintain its performance without its current owner. Together, sustainability and transferability ensure the health of an organization by increasing its overall value.

Like most things in business, sustainability and transferability cannot be achieved overnight. They develop gradually and result from years of carefully balancing business drivers (such as growth, recurring revenue, market share, and customer diversification) and asset drivers (such as finance, operations, human resources, and sales and marketing).

Sustainability and transferability are also difficult to build on your own. They require the strategic business decisions and long-term planning that a skilled business advisor should assist with.

Whether you've recently opened a business or have been managing one for years, it's never too early to start planning for your exit. Creating value is a long-term investment, but well worth the effort. Placing it at the core of your business plan will allow you to build your business to last for decades, but will prepare you to sell tomorrow. Because you can't always plan your date of departure, nothing could be more important.

For more information and to register for a complimentary seminar on the topic, which will be held September 24th, please visit our website at www.w-group.com or by e-mail at: seminar@w-group.com



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Fair Market Value – An Important Part of Tax Planning

For most small business owners, the business is their main and most important asset. At some point, many owners will go through a tax planning process involving their business. During this exercise, a tax specialist will review your situation and develop tax strategies to help achieve your goals, which usually involve reducing future income taxes.

One of the strategies that might be recommended is an estate freeze. In an estate freeze, the value of the shares owned by you is frozen and the future increase in value of your business is taxed in the hands of another person, usually a family member. For this type of transaction, tax law requires that the "freeze amount" be at Fair Market Value (FMV). When structuring an estate freeze, the tax specialist will include a price adjustment clause in the agreements. The purpose of this clause is to avoid immediate tax consequences if Canada Revenue Agency (CRA) does not agree with the FMV used in the tax plan. CRA requires that

a fair and reasonable attempt be made to determine the FMV in order for the price adjustment clause to apply.

A Chartered Business Valuator (CBV) is a trained professional specialized in determining the FMV of businesses. Some business owners will prefer to determine the FMV themselves or will ask their accountants to do a quick calculation instead of asking a CBV to determine it. They will do so believing that the price adjustment clause will protect them. However, based on discussions we have had with CRA, a valuation report prepared by a CBV is more likely to meet their requirement, whereas the other calculation options might not. Under CRA's current requirements, it is our understanding that having a CBV calculate the FMV will mean that the price adjustment clause (if it was used in your agreements) will apply and that there will be no immediate tax impact for you.



Speak with your Welch LLP tax specialist about when a CBV should be involved in order to achieve your tax goals.

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Differences in Not-For-Profit Financial Statements

Financial reporting for not-for-profit organizations (NPO) differs from reporting for a profit organization (FPO) in many ways.

An NPO Statement of Financial Position, similar to an FPO Balance Sheet, depicts an organization's financial situation at a reporting date (year end). In the same way that you would review a balance sheet, by reviewing an NPO's statement of financial position, users can assess whether there are enough resources to provide services and meet obligations. However, whereas an FPO statement has a shareholder's equity section on the balance sheet to show the owner's stake in the business, NPOs calculate Net Assets.

Net Assets, also referred to as fund balances or accumulated surplus or deficit, show the organization's resources available for different programs or projects. Net assets can be

classified as restricted assets, temporarily restricted assets and unrestricted assets. Restrictions may be imposed on net assets externally or internally. The amount of resources subject to restrictions and the nature of the restrictions can have a significant effect on the organization's financial flexibility and ability to provide certain services in the future.

Also, recent changes introduced in the Canadian Institute of Chartered Accountants Handbook relate to how NPOs are required to recognize investments. Investments must be classified as available-for-sale (AFS), held-for-trading (HFT), or held-to-maturity (HTM). Measurement of their value for statement presentation, treatment of gains and losses, and notes to statements are all affected through these changes. Another difference between the statement of operations for NPOs and income statements for FPOs relates to

how an NPO amortizes its capital grants. In an NPO, capital grants given for the acquisition of capital assets are deferred until the organization purchases the assets. These deferred grants are then amortized and brought into income on the same basis as the amortization expense related to the acquired capital assets.

Although there are differences in reporting, the main purpose of both NPO and FPO statements is to provide users with accurate information as to the entity's financial well being.

For help in navigating the ever changing world of NPO reporting consult your Welch LLP professional.



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GST Rebate Claim on Discretionary Investment Management Services

Taxpayers who paid GST and QST on discretionary investment management services may be entitled to claim a rebate for tax paid in error as a result of a recent case decided by the Federal Court of Appeal. The court decided, in the case of *The Queen v. The Canadian Medical Protective Association* that, based on the facts of that particular case, discretionary investment management services were not subject to GST.

Canada Revenue Agency (CRA) was not happy with this decision and may appeal it, or may work with Department of Finance to have the GST legislation changed retroactively to ensure that such fees remain taxable. Until a final decision has been reached, there will be uncertainty with respect to the ultimate payment of any rebate claim. However, because of the time limitation, in order to preserve the ability to claim the rebate, taxpayers who wish to file the claim must do so now even though the outcome is uncertain.

This rebate claim is available to any person, including individuals, corporations, trusts, etc. that have paid GST and QST on discretionary investment management services and have not claimed input tax credits or refunds in respect of the tax on those payments. The rebate could be several hundred dollars, depending on the value of the investments subject to the fee. For example, on a \$6 million investment portfolio subject to a 0.35% fee, GST at 5% for one year would be \$1,050.

The claim is subject to a time limit of two years from the date of the payment, so a claim made on September 30, 2009 can only include payments made in September, 2007 and later.

Any rebate received will be subject to income tax, assuming the original payment of GST tax was claimed as an income tax deduction. To help you submit your credit claim please contact a Welch LLP professional.



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Marriage, Common Law and Taxes

The Canada Revenue Agency taxes married and common-law couples (same or opposite sex) on the same basis. While legally married couples are easily defined, common-law couples are not.

For tax purposes two people are considered to be in a common-law partnership when:

- ✦ they have lived together in a conjugal relationship for more than twelve months
- ✦ they have a child together or have adopted a child together
- ✦ one partner has custody of a child
- ✦ who is wholly dependent on the other partner

Once determined to be common-law or married, couples will notice changes on their tax returns. Some changes can be beneficial, like the ability of a low income spouse to transfer credits like age, disability and tuition to the higher income spouse. Other effects can be punitive, like GST rebates. A single person earning less than \$30,000 will be eligible for a GST rebate of

approximately \$250 per year. However, a couple earning \$50,000 will not be eligible for any GST rebate.

Couples can also do some basic retirement tax planning that is not available to individuals. If one partner expects to earn significant retirement income they can make spousal contributions to the other partner's RRSP account resulting in the both partners having retirement income. The ability to split income can provide significant tax savings. Another form of splitting will occur for couples where one partner earns significant pension revenue.

Couples are also capable of maximizing certain credits by pooling expenditures together. One such credit is the donation tax credit. Individuals receive a 15% tax credit on the first \$200 donated and a 29% tax credit on any

excess. By pooling donations, couples can maximize the amount subject to the increased rate. Another credit that can be maximized is the medical expense tax credit. This credit is limited to amounts in excess of 3% of net income or \$1,962. Once again, by pooling expenditures, couples can maximize their tax credit.

Common-law or married couples also have tax advantages upon death of one of the partners in that all of the assets of the partner can be transferred to the surviving partner on a tax free basis. Upon death of a single person all assets are revalued at fair market value which can result in a significant tax burden. To learn more about how you can save tax please contact a Welch LLP professional.

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