



CIBC PRIVATE WEALTH

The privately held business



Fulfill the promise of your ambitions

What's your vision for success? We've learned that success often means achieving a sense of satisfaction and joy about the use of your wealth for yourself, your family and causes you hold dear.

It also means having peace of mind about your financial affairs, trusting that your wealth advisor is managing the complexities of wealth ownership. Additionally, for some, it means that plans are in place to realize your vision for broader community impact and a lasting family legacy.

CIBC Private Wealth can be your partner for all of your investment, wealth planning and private banking needs. Our professionals are dedicated to delivering exceptional performance and service with an unwavering focus on you and your best interests.

We hope the information on the following pages will inspire you to articulate your own vision for your wealth. It would be our privilege to help you bring your ambitions to life.

Contents

| | |
|--|----|
| Keeping it in the family: Love, harmony and a good estate plan | 3 |
| Still in the family: Family dynamics | 10 |
| Heading for the exit: Selling to a third party | 16 |
| Pre-liquidity planning: Before you sell that business | 23 |
| Resources | 31 |



The privately held business

Keeping it in the family:

Love, harmony and a good estate plan



Keeping it in the family

There is much at stake with interests in a privately held business, especially when the discussions about passing those interests down or passing them on to third parties begin to take place. In this section, we take a look at the issues every business owner should examine when beginning a transition plan centered on keeping their business interests in the family.

Beloved family touchstone for current and future generations? Or prescribed and confining life path that limits individuals' pursuit of their own dreams? A privately held business can be these things—and much more. Beyond the opportunity for significant wealth for its owners, a privately held business often represents prestige, job security, control over financial destiny, multi-generational legacy and the very thing that gives the family its sense of “who we are.” For those who have a strong desire to see a business continue in the family for generations, the business represents the entire spectrum of human emotions. At no other time are both emotions and hard business decisions put into as much play as when this question surfaces: “What is the next step for our privately held business?”

Family business truths

At some point a family business, regardless of size, faces the issue of transition. Perhaps the founding, first-generation owners are facing declining health or a desire to have more time to enjoy the fruits of their labors. Or the second generation has successfully grown and managed the business and can now realistically visualize a transition to the third generation. Or perhaps the business itself is facing a critical juncture, with the need for fresh everything—funding, strategy, products, partners and markets—and a new generation of talent to make that happen.

Whatever the reason for thinking about the transition of the business, it's imperative that the family clearly communicate and outline that the business is actively engaged in a succession plan. For the founding and active owner and spouse, the importance of planning, especially if the owner is anxious about giving up control or a possible change in financial security, can't be overstated, says Christopher M. Goodrich, a partner with Crady, Jewett, McCully & Houren LLP of Houston.

“A business owner is confronting his or her mortality when developing a succession plan, an obviously delicate topic made even more sensitive by the owner's dedication to his or her business. In addition, many entrepreneurs treat their business as another child that they have raised and nurtured, resulting in control issues that may interfere with the transition of the business to the next generation,” says Goodrich. “The current and future role of the owner's spouse must also be explored. Depending on the spouse's relationship to the business, it may be appropriate for the spouse to succeed to ownership and/or control of the business upon the owner's death or incapacity or to act as a figurehead for the business, even if serving as the CEO of the business in name only. The spouse also frequently has influence as the ‘chief emotional officer’ within the family. The owner's feelings about passing on the business to the next generation may not be the same as the spouse, who is looking at issues from different perspectives.”

For this founding-generation owner and spouse, two sets of questions—personal finances and family considerations—are critical. Establishing your own personal goals is first. While some of these will necessarily overlap with family goals, the personal ones have every right to be addressed first. Broad goals include liquidity, family legacy, philanthropy and lifetime income; owners should work through both sets of questions for each goal.

Financial considerations:

- Will you be able to retire when you want?
- Will you and your spouse (and the survivor of you) be able to enjoy your lifestyle independent of the business interests?

- Is there enough liquidity to pay estate taxes so the family won't lose the business interests or see the business financially crippled?
- What estate and trust options should you consider?
- If you sell, how will the assets you receive be invested?
- What means of support do your children have?

Family/nonfinancial considerations:

- Do you want to keep the business interests in the family or sell them to a third party?
- Will the business interests pass only to the child or children who are active in the business? Are your children really competent to run the business? Are there other key employees who need to be retained?
- If they are not already, when do you want your children involved?
- How will you establish a "control" process to avoid family disagreements?
- Will you treat your children equitably or fairly? (There's a big difference.)
- Do you need to stay involved in the business?
- What are your charitable objectives?
- What is your comfort zone on: giving up control, when and to whom, and paying gift taxes now to achieve your goals?

For the business owner and spouse who are actively creating their estate plan concurrent with the business transition plan, the key is to find strategies to achieve as many of these competing objectives as possible in a tax-efficient manner.

What about the children?

Do they have "the will" and "the skill"? In a nutshell, that's what it comes down to when deliberating about whether the next generation should come into the privately held business—even for those businesses in which a second generation is already employed. Most businesses, even small, family-owned ones, can't afford to stay at status quo. So even if the owner's children are helping run the business now, it's imperative to examine whether they are the right choices to take the business to the next level. Particularly for a business that plans to bring in—and support in a meaningful way, both financially and emotionally—third and fourth generations, the business will have to grow.

The question, however, extends beyond the competence of the children to run the business. In many families, the rising generation must learn the skills and disciplines of thoughtful ownership and, even more importantly, they must learn to collaborate together as a sibling team. Business failures often are not the results of poor planning; they are often the results of failed family cultures. Families that are not bound by a common purpose and not characterized by trust and vibrant communication are unlikely to stay in business for long. Sometimes families can part peacefully, but often the separation is personally and fiscally ruinous.

Even if the family is able to overcome these obstacles, it faces daunting future challenges, particularly as the business transitions into the third generation. As a family grows and possibly becomes more reliant on the business for living expenses, the second generation often must be willing to reinvest capital in the business to "front-load" the growth of the family enterprises. This imperative to grow often means that the family must also diversify its wealth among different business interests and more traditional investments to keep pace with the encroaching "law of large numbers."

Beyond "will" and "skill," there are numerous important questions for the family to consider as it moves forward. The traditional model of the matriarch and patriarch making all of the estate planning decisions is breaking down rapidly. Increasingly, wealth holders are involving their children in the core questions of the estate planning process. Warren Buffett has said, "Your children are going to read the will some day ... It's crazy for them to read it after you're dead

... You're not in a position to answer questions—unless the Ouija board really works. I do think it is very important in wealthy families once the kids are a certain age ... they should be participants in the will.”¹

In this sense, estate planning is moving beyond a personal responsibility to a family responsibility. For those who say that their children couldn't participate in that discussion and who fear the involvement of their children in such decisions, one has to ask the question, “If they can't engage in even this simple discussion, what makes you think they will be able to be in business together over the course of the rest of their lives?” As it turns out, many founders find this kind of conversation provides great insight into what life will be like for their children after the parents are gone and shapes the planning in ways that will likely avoid disaster.

When considering the children's potential role in the business, the founder needs to consider numerous questions: Is it simple “fairness”? How do you define “fair”? Is there an automatic right of entry? What are the “rules” to being an owner? What are the children's expectations? Does the second generation have the right to pass ownership shares to their own children? Or do those third-generation children have to earn their way in? And business owners mustn't forget one of the most basic questions of all, the one to ask as a parent: Is being in this business right for my children at all? “There's no fitting a square peg into a round hole,” says Goodrich. “The artistic child is not likely to have an interest or aptitude in finance. Be realistic—and compassionate. Your children don't want to disappoint you, but they have the right to make choices about their own lives.”

Preserving family harmony

The family may also have to engage in decision-making that will seek to preserve family harmony—and in most family businesses, there is unavoidable tension between harmony and the demands of the marketplace. Family harmony is fostered by treating all children equally, thereby avoiding perceptions of parental favoritism. But treating children equally may not be possible where some children are involved with the business and others are not. The business's survival is generally enhanced when the most able and involved children retain control of the business. From the parent's perspective, those children retaining control may be a rational and fair solution because the business is set up for continued success. However, from the children's perspectives, this may appear to be favoritism of one child over another.

The business owner may be tempted to try to solve this problem by simply making a decision alone, but any such decision is likely to backfire in the long run. No decision that is opposed by the family will survive long after the death of the last surviving parent. It is far better to craft a decision that involves those most affected. This process might require outside facilitation, and the conversations may be difficult, but the results of coming to an agreement before the death of the founder can preserve both family harmony and financial value. And if the family can't agree, the owner will have far more information to work with as he or she plans for transition.

Often, there will be tension between children already active in the business, or those who plan to be, vs. children who want no part of it but who benefit from it financially. The nonactive children may believe that the compensation and benefits provided to the active children are excessive, and they may question business decisions even when they know little about the operations, economics or competition of the business, says Goodrich. Active children may resent that their hard work to increase the value of the business benefits nonactive children, who did not make the same efforts on behalf of the business, failing to recognize that if nonactive children have equity ownership, they have a right to the economic benefit of the business. “We've seen many business owners who feel very conflicted when trying to treat their children fairly and also direct the vision for the business's future,” says Goodrich.

Again, rather than attempting to resolve this question for the family, the wise family leader will ensure that the children are educated and informed about the issues, and then involve them in the solution to these dilemmas (after all, it is

¹ “Lessons in Estate Planning from Warren Buffett” (includes excerpts from Q&A with Warren Buffett at the May 5, 2013, Berkshire Hathaway Annual Shareholders meeting), by Thane Stenner. *The Globe and Mail*, May 19, 2013.

the children who will have to deal with the consequences, and the last thing most parents want is to sow the seeds of inevitable dissension). The more enlightened path is to resolve these issues in family conference. And, as before, if resolution cannot be reached while the parents are alive, it will almost certainly not magically transform after the last parent dies.

The attributes of successful and enduring family businesses

To be successful as both the company and the family grow, a family business must meet two intertwined challenges: achieving strong business performance and keeping the family committed to and capable of carrying on as the owner. Five dimensions of activity must work well and in synchrony:

1. Harmonious relations within the family and an understanding of how it should be involved with the business
2. An ownership structure that provides sufficient capital for growth while allowing the family to control key parts of the business
3. Strong governance of the company and a dynamic business portfolio
4. Professional management of the family's wealth
5. Charitable foundations to promote family values across generations

Source: "The five attributes of enduring family businesses," McKinsey & Company, 2010.

The business's value: Says who?

A starting point for the planning process is a business valuation and a valuation of nonbusiness assets. Many company founders have a mix of liquid and longer-term investment assets, business and personal real estate, life insurance, retirement accounts, trusts and tangible property. Some are easier to value than others, but the value of the business may be the most difficult. In addition, it raises issues the owner must consider carefully.

For a sale to an outsider, you would generally prefer the highest valuation possible. But if you want to gift the business to your children or create an intra-family transfer, a lower valuation is usually desirable. Even more complicated is if you plan to give it to only one child at a very low value. The children not involved in the business may believe the business is really worth much more and that they are being short-changed. There are numerous, and complex, techniques to gift business interests (see discussion below) and many of the techniques use valuation discounts to reduce significantly the cost of gifting business interests to family members.

The business's value can be determined in one of three ways: cost approach (adjusted book value analysis), income approach (discounted cash flow method) or market approach (comparable company analysis). Both positive and negative attributes that affect value must be considered. Positive ones include repeat/recurring business, being a market leader, holding patents or a technological advantage, having a diversified customer base and being in middle-stage growth trajectory. Negative attributes can include discounting the value because of small size and the loss of the key person (the founding owner), being a cyclical business, having a commoditized and nonproprietary product or service, or being in late-stage growth trajectory. An experienced business valuation consultant is a necessary part of the business transition planning team and will be most effective knowing the owner's goals upfront.

Getting the business interests down to the next generation

Like any family, individual or situation, there's no one "right" plan to transition business interests to the next generation. An individual plan must be designed to serve the interests of all parties—including the estate of the owners/founders. The most common situation is that some, but not all, of the owner's children are active in the business. These situations present the most difficult challenges. Ideally, the owner's estate has enough assets to equalize the estate among all the children, with the business passing to the children working in it and other assets passing to children not involved. Most often, however, the family business represents a disproportionate amount in the owner's estate. In these situations, the business owner must find a way to provide equal distributions to all of the children, or accept a disproportionate distribution. Ideally, we can develop a plan that balances the owner's objectives of maintaining family harmony while the children active in the business continue on without undue interference from the children not active in it.

Here are some of the more common techniques for moving business interests into the hands of the next generation:

Grantor retained annuity trust (GRAT): Using a GRAT, an owner can transfer a business interest to family members at a reduced gift tax value and retain the right to receive annuity payments for a fixed number of years. The annuity amount is a fixed dollar amount or fixed percentage of the initial value of the trust assets. After the trust term expires, the remaining trust property passes to the trust beneficiaries. In addition, the annuity stream to the owner can be used to fund additional GRATs, creating "rolling GRATs." The rules on gifting to a GRAT are very complex, even though they have a big advantage: years of strong case law and regulatory guidance. However, it is always important to be mindful of the potential for changing rules.

Transfer of the business shares, voting vs. nonvoting: This option essentially reorganizes the business to create two classes of interests, which allows the owner to gift nonvoting interests while still alive, yet retain the voting interests and control. Or, the owner can gift voting interests to active children and nonvoting interests to nonactive children.

Installment sale to children: Structuring an installment sale of business interests to one or more children revolves around the owner receiving at least one payment after the tax year in which the business is sold, which allows spreading the taxable gain over time and deferring a portion of the tax liability on any profits. Rather than a one-time payment (assuming the children could even do that) with an immediate tax liability, each installment payment is treated as return of capital, gain and interest income. Under this scenario, the owner must be willing to give up control of the business—the responsibility for it and its future appreciation rest completely with the children. An installment sale carries the advantage of more easily "equalizing" the owner's estate if there are multiple children—they are, after all, purchasing the business, not receiving portions of it as a gift from the parents.

Installment sale to grantor trust: In this technique, the business owner seeds the trust with a gift of approximately 10% of the value of the purchase price of the business to provide equity in the trust. The business owner then sells the business or a portion of it in exchange for an installment obligation from the grantor trust. Transfers between the trust and the business owner typically have no income tax consequences.

Life insurance: A life insurance policy can be simple and economically efficient way to provide liquidity and can equalize distributions among children, provide income to a surviving spouse, pay any estate taxes or let children buy out the owner's interest. Ideally the life insurance should not be included in the estate of the business owner. Otherwise, a portion of the life insurance will need to be used to pay estate taxes on the life insurance, making it unavailable for its intended purposes.

When continuing income to the owner is a goal, numerous techniques can be used: dividend distributions (as long as the retiring owner owns some interest in the business), consulting arrangements, even noncompete payments. (Yes, the owner could actually be contemplating starting another business.) In addition, don't forget to include in business transition plans possible future situations like divorce and remarriage. "This is often real life at its most vexing, but must be considered," says Goodrich. "When carefully structured and negotiated, and with the proper disclosures, pre- and

post-marital agreements can provide substantial certainty with respect to the disposition of business interests in the event of divorce.”

The question with all of these techniques is whether the family has the willingness and capacity to make them function. The family must be prepared through education, skills development and deep conversation to support the plan effectively and have the ability to make these plans productive, as designed. Plans that either generate entitlement or sow the seeds of protracted conflict may be tax-efficient, but often at an unacceptable cost in familial suffering.

Giving up and passing on a business is a major, life-changing event with a whole host of complex issues and often-difficult decisions. While it could result in family strife, if done well, it also has the potential to be a golden opportunity to realize business, family, legacy and philanthropic goals after years of hard work and sacrifice.



CIBC PRIVATE WEALTH

The privately held business

Still in the family: Family dynamics



Still in the family

Business—in general—is tough. It always has been and always will be. Add to this eternal truth the word “family” and you add multiple layers of complexity. Navigating family dynamics in a business is a crucial part of business transition planning—and doing so successfully can lead to endless possibilities.

Today, it’s entirely possible that three, even four, generations are trying to figure out how to coexist peacefully in the workplace—from the silent generation’s insistence on daily desk time to Millennials’ comfort with working from a mobile device in a coffee shop at 7 p.m. It’s hard enough in any company, but the challenges can run even deeper for a family business. When a business is being passed to many generations, the family dynamics, including the issues and definitions of “family wealth,” can become even more complex and more of an ongoing challenge, even in the family businesses that appear most successful.

“The primary driver of wealth creation is success in business, often a family business,” says James “Jim” Grubman, Ph.D., of FamilyWealth Consulting, an internationally recognized consultant, speaker and educator in the multi-disciplinary field of wealth counseling. “A family that shares ownership or management of a business can reap many benefits unavailable to other families. Many of those with whom I’ve worked over the years feel very honored and appreciative of the fact that they are able to be productive and successful together. But a family business also must contend with powerful stresses that can destroy love and create rifts that can last for decades. That’s why it is so imperative that all of those who care about and hold the business dear, including key employees, advisors and other stakeholders, understand the universal themes about family dynamics within a family business.”

Recognizing—and navigating—family dynamics

Family businesses are a breed unto themselves, and business families deal with two extraordinarily complex systems: the business system and the family system. Each has different purposes, different rules and different measures of success—and what might be summed up as two different operating systems. The way these two systems interact in times of transition and stress can cause things to fall apart. Families often find that they are not prepared to handle the inevitable consequences of the collision of these two radically different systems.

Typically, the operating systems developed along two parallel tracks. The entrepreneur often spent years building a business that was born in the cauldron of competitive markets, complex business issues, tough finance environments and so on. To survive, the business needed to foster a culture of excellence. Meanwhile, the family developed along very different lines. Here, the children were nurtured, educated and loved. To thrive, the family has to create a culture of inclusion.

When these systems inevitably come together, the operating systems of “excellence” and “inclusion” often collide in spectacular fashion. The consequences are predictable—with tendencies of families to favor one operating system over another. Companies hire family members who may not be qualified, thereby favoring inclusion over excellence, or they exclude family members from ownership, favoring excellence over inclusion. Almost all problems of succession can be seen through this clash of operating systems. The complexity and confusion arising from the collision of operating systems can be substantial. Families will spend years attempting to carefully tease these apart in ways that allow both the business and the family to survive and function at higher levels than they did before the transition. Unfortunately, many don’t make it.

Some of the ways these clashing systems manifest themselves are:

- Families that can’t stop talking about business when they need to
- Siblings working together who bring business conflicts to family gatherings, or siblings who carry old “rivalries” into the business

- Founder parents who create either too rigid boundaries between the family and the business, or too loose ones
- A “family democracy” model applied to the family business, with no clearly defined roles or accountabilities, and often without true business leadership
- Children who cling to the dinner-table business war stories of their parent-founder, while also yearning for their own starring role in such a family business story

A common pattern seen in family businesses is one in which a child is brought in to succeed the founding parent, but the founder refuses to relinquish real authority. Often, the parent’s health fails or the parent dies before the children take over. And all too often, the value of the business has eroded. While this example highlights the perspective of the waiting-in-the-wings, next (often frustrated) generation, a common stumbling block for the generations in a family business is that the founding generation believes that the second or third generation in the business simply doesn’t share the “magnificent obsession” with the business. Founding generations may be so focused on making sure that their children and grandchildren understand this obsession before they let them “take over” that they fail to recognize that succession in the family business is a long journey—a process, not an event.

This is only one of the patterns common to business succession. Another pattern involves the anointing of one child above the others as a successor. This often breeds resentment and anger within the family system. Yet another pattern involves bringing multiple children into the business with the expectation that one will emerge as the “winner” to lead the company, while the others will either exit or live in the shadow of the victorious sibling. In addition, some families, by unexamined agreement, divide into “teams.” Common teams are boys versus girls, blood relatives vs. those who married into the family, older vs. younger children or family branches vs. each other. The sides square off to see who can gain the greatest advantage. These patterns all develop as the family attempts to cope with the clash of operating systems and the tensions generated by the operation of power and love within the family and business systems.

As the Family Office Exchange advises, “The issue is not the unplugging of one leader and plugging in of a new one, but developing the capacity for the whole system to develop, collaborate and support leadership. Succession in family leadership is usually not just a change of person; it means changing the family governance structure—from an individual to a sibling group to a larger network of cousins, for example. The real issue is the evolution of the enterprise and the development of leadership capacity to guide it. Families can capitalize on generational transitions as advancement opportunities, rather than surviving them as crises of lost authority.”²

Adds Courtney Pullen, M.A., a psychologist and family wealth counselor, “Leadership acumen is a very different skill set than being a manager or an operations expert. It’s critical in a transitioning family business and something that founders need to place a high priority on if their business is to pass and succeed into the next generation. Most successful family business owners recognize this truth, because they often hold in their hearts the desire for the business to be taken into the future by a family member. But a big part of the family dynamics in a family business is for the founding generation to be able to honestly answer the question, ‘Am I hiring a child or an employee?’ And, ‘Can these children be leaders?’”

So, is navigating family dynamics successfully a matter of it being a unique group of people in business who just happen to be in a family, or is it simply applying best practices of business to any family? “In many ways, it’s about the people,” says Grubman. “Individuals and families vary in the degree to which they are resilient, open, communicative and adaptable—and adaptability is the single most important quality that will result in a family business prospering. On the other hand, a family in business together is dealing with a level of complexity that doesn’t exist for either ‘regular’ families or other types of business.”

Honoring transitions

“‘Succession’ within a family business is often viewed only as the older, founding generation letting go,” says Grubman. “But succession is as much about a ‘taking on’ by the new generation. ‘Transition’ is a more accurate term, reflecting

² “Succession in Business-Owning Families,” Family Office Exchange, 2005

the changes in both generations.” Successful passage through the letting go and the taking on—again, a process, not an event—is probably the most important attribute of a successful, multi-generational family business.

“Everybody in the family is going through this generational transition together and separately,” says Pullen. “It’s a stew of complex emotions. Old sibling rivalries and long-suppressed memories of parental ‘favoritism’ may surface. Yet some, or all, members of a next generation are now charged with stewardship of a precious resource, the family business, at a time when they might feel somewhat fragile. And they still have to sit together around the Thanksgiving dinner table.”

The letting go by the founder can be a source of younger generation eye-rolling (“Why can’t Mom and Dad just get on with it?”) and older/founding generation mild disappointment (“They have no idea what this is like for me.”). For all the reasons why letting go is the source of stirred-up family dynamics, Pullen suggests that family businesses step back and take some time to honor the transition. In fact, he says the family should even think about ritualizing it. “In the same way that we feel the urge to ritualize the departure for college, the first adult job and the big birthdays, families should develop a way to ritualize the transition,” says Pullen. “The ending of something can be the opportunity for a more satisfying passage and an incredible new beginning, but if we don’t honor an ending in a clear way, the beginning is somewhat polluted. A process of ritualizing a family business transition brings something.”

Pullen says that people in major life transitions are actually in chaos. The coping skills, attention spans and general abilities for making appropriate short-term and long-term decisions are diminished during a transition. The status quo has been broken; family members in a business are encountering their version of fight, flight or freeze as they try to cope with uncertainties, fears and confusion around the change. “It’s very important that family in a business together rely on a team of advisors, including a psychologist or counselor, to work through the sometimes messy transition process. Caterpillars get to do their transitions in the privacy of their cocoon; we humans must cocoon in public, and it is not always pretty to watch.”

Beyond these capacities and capabilities are some hard realities. Typically, the founder of the company wears all the important hats in the business. The founder makes all of the strategic decisions, runs the company to meet those strategic objectives and reaps the benefits of that work. In the second generation, these functions are separated—we might call them governance, management and ownership. Families that tease apart the operating systems become adept at navigating the boundaries between these functions. They have educated owners, competent managers and wise board-level leadership. These families spend substantial time helping the rising generation understand and adopt these distinctions.

Beyond that, these families help the rising generation develop genuine financial literacy, to ensure that they don’t squander money; wealth literacy, so that they grow personal wealth independent of the family business; governance literacy, so that they can work together with other family members; and often philanthropic literacy, so that they can give money wisely in ways that benefit society and the family social networks.

Confronting fears and embracing possibilities

Any transition brings with it increased anxiety. Successful transition in a highly functioning family business with one or more generations involved requires confronting those fears. Oftentimes, the senior generation expresses one or more fears related to:

- Watching the business fail
- Relinquishing control
- Becoming irrelevant or bored
- Losing financial security

At the same time, the next generations commonly have their own fears, including:

- Displeasing the senior generation
- Failing to grow or maintain the business
- Disagreeing with their own generation

Confronting the fears of all involved should be high on the to do list for any family. Once the family's fears are acknowledged and addressed the family can better move forward to the possibilities the future holds for them and the business.

Family businesses, says Grubman, can be likened to pioneering immigrants: "Pioneers work to go to and explore distant opportunities," he says. "The best family businesses think of themselves that way, knowing that the journey and the adjustment will not necessarily be easy. But while the challenges for family members in business together may sometimes seem daunting, the flip side of the coin is that, for those willing to stay energized about a successful and harmonious family business (and family), the possibilities for the future are almost endless."

When families are able to navigate the power and love resident in the family and business systems by creating a deep common purpose, and then cultivate the capacities and skills necessary to achieve that dream, they create paths that benefit the individuals in the family, the family as a whole and the world beyond the family.

Updating those family business statistics

Discouraging statistics about the success and failure of family businesses are frequently cited, the most common being that only about 13% of family businesses last beyond the third generation. These figures come from research done in 1987 by John Ward, Ph.D., a professor at Northwestern University and a highly regarded family business consultant. But more recent research, from three professor-researchers sponsored by the Family Firm Institute (FFI), has more positive results, says James "Jim" Grubman, Ph.D., of FamilyWealth Consulting. "The new research uses better methodology, and I believe it paints a much more accurate picture of families in business," says Grubman. "For example, a family business may fall into the statistic of being 'gone' after 10 years, but it may be a situation in which the family has simply exited that business and gone on to create another successful venture. The point is to focus on the family, not necessarily the business, when family businesses make transitions."

The goals of the research study were to challenge the assumptions of family business survival statistics, shift the wealth creation vehicle from firm to family, challenge the tendency to generalize about family firms (they are not a homogeneous population), and explore the impact of entrepreneurship on longevity and family firms. Among the most interesting findings are:

- Families in business are very entrepreneurial—the average number of firms controlled over the history of a family in this study was a surprising 6.1 firms, with an average of two industry shifts.
- Transgenerational value creation drivers are built on internal autonomy (independence of teams within an organization), external autonomy (independence of the firm from external stakeholders) and acquisitions. In short, survival is not the same as transgenerational value creation.
- Oft-cited survival statistics are used out of context and may not be generalizable. As the study points out, only 25% of all firms, not just family businesses, last 10 years.

Source: The FFI - Goodman Longevity Study, Family Firm Institute, Inc.

About our contributors

James “Jim” Grubman, Ph.D., is an internationally recognized consultant, speaker and educator in the multi-disciplinary field of wealth counseling. He works with affluent families and their advisors to understand the many ways that wealth and life can be integrated successfully. He also teaches, trains and collaborates with advisors. His book, *Strangers in Paradise: How Families Adapt to Wealth Across Generations*, is available at Amazon.com in print and e-book versions.

Courtney Pullen, M.A., is the president of the Pullen Consulting Group. He has more than 25 years of experience in individual and family coaching, business and management consulting, leadership development, communication training and team building. He has extensive experience in small and large group facilitation covering the continuum from family meetings to corporations. Pullen’s book, *Intentional Wealth: How Families Build Legacies of Stewardship and Financial Health*, is available on Amazon.com.



CIBC PRIVATE WEALTH

The privately held business
Heading for the exit:
Selling to a third party



Heading for the exit

For many people who own an interest in a privately held business, the goal is to build the business into a successful enterprise that can be sold. If that describes you, here's what you need to know about positioning your business interests—and yourself and your family—for the sale and for life after the business.

The challenges for a privately held business are similar to what almost any business looking toward the future must confront: the need for additional capital to grow, acquire, modernize or innovate; the general economic outlook (including the ability to respond during economic downswings and upswings); and the competitive landscape.

Considerations for selling a privately held business often revolve around three factors: economics, emotion and need. In addition, wealth diversification for the founding owner is a key factor in the ownership-and-succession decision matrix. Sometimes continuing to own the business moves to second priority as the owner realizes that liquidity and diversification have become more important at a certain stage of life.

When a family decides the right and best choice is to sell its interest in a business to a third party, the work begins in earnest—and so does the uncertainty.

Selling: A long-term process

Although it happens often with business owners, six months is most certainly not the ideal time frame for preparing to sell the business. The family should be thinking more in terms of a planning, preparation and implementation phase of at least three years.

Certainly, the emotions of selling the business need to be worked through, which may take some time, but it is essential that the business itself be best positioned for sale. First and foremost is to clean up the balance sheet. Often, there are expenses run through the business that really should not be, or loans to family members or other owners that have never been paid back. Receivables generally should be kept as current as possible or written off—bite the bullet and get rid of them. Most important is the structure of the business. Are there valuable strategic alliances and long-term contracts with suppliers or vendors? If so, they may need to be locked down. If the business requires real estate to operate, long-term leases may need to be in place. All of these things can add value to the business when the time comes to sell.

The business also may need to secure agreements with essential employees and key management before a sale to third party. Retaining these nonrelated key employees can be critical, advises Christopher M. Goodrich, an attorney with Crady, Jewett, McCully & Houren LLP in Houston.

"The business owner must focus on how to motivate these employees, who will be instrumental in running the business after the sale," says Goodrich. "They are often in the best position to judge the worth of the company and are very motivated to ensure its continued survival and prosperity. A business can use bonus arrangements, non-qualified deferred compensation plans with long-term vesting requirements, stock option plans and ESOPs, all of which can tie the employees to the business long after the founding owner leaves. If certain key employees decide to end their relationship with the business, 'key man' insurance can be used to fund a buyout, if necessary, and to train and hire replacement employees."

Goodrich says the founding owner must also consider contractual arrangements (such as a franchise agreement), professional licenses, or certifications (minority- or woman-owned business) that can be critical to the successful transition of the business. CIBC Private Wealth worked with a privately held business client, an engineering firm, in which there was a wealth of organic knowledge, but no written processes and procedures. Another one of our clients, a 50-year family business, had dutifully recorded shares sold to family members and gifted to key employees—at least most of the time. When it came time to sell, there was no accurate record of who owned what percentage. It's often important to look closely for anything that could negatively affect selling and transitioning the business. We also worked with a privately

held business that was contractually bound by a controlling distributorship agreement, under which the business could not transition in any way—either to the next generation of family or to an outside third party—without the distributor approving the sale. Selling to a third party requires the business to be fully self-sustaining, especially as it relates to processes and documentation.

Structuring the sale

There are numerous ways to structure the sale of a privately held business: a lump-sum sale, an installment sale, an earnout sale based on a percentage of future profits or a sale to a charitable trust. A business owner may sell the business interest by transferring either the entire ownership interest (stock, partnership interest, membership interest) or just the assets of the business. The desired “end result” will help determine a sale’s structure.

“If, for example, the owner wants to sell ownership, but not control, of the business, a tax-free reorganization can be used,” says Goodrich. “The interests in the business are recapitalized into voting and nonvoting interests prior to the sale. After the recapitalization, the owner may sell the nonvoting interests to third parties in exchange for cash or a promissory note and retain the voting interests and control of the company. In a cash sale, in which the owner receives a lump sum of cash or property in exchange for all or a portion of his or her interest in the business, capital gain is generally recognized in the year of sale to the extent that the sales price exceeds the owner’s basis, although there are exceptions.”

The sale can also be an **earnout**. The purchase price of a business with an earnout agreement includes a contingent payment based on the company’s future performance or some other matrix. The contingent purchase price is generally “earned” if certain future benchmarks are reached during a specified period after closing, and often includes a sliding scale on which the contingent payment will be made. “Earnouts are typically useful when there is a gap between a seller’s expectation of future profits and a conservative purchaser’s estimate of the value of the business without the business owner’s ongoing involvement. Earnouts may also be used to motivate and retain key employees of the business,” says Goodrich.

An **installment sale** can also be used, although this type of sale is more frequently considered if the business is being sold within the family. The big advantage is that it can provide regular cash flow to the departing founder. But it is best used for the sale of a stable business so that the cash flow is available for the new owners to make the installment payments.

There is a big difference, to both buyer and seller, between an asset sale and a stock sale. In an **asset sale**, the purchaser acquires part or all of the assets of the selling company and gets a step up in basis on the assets purchased. The selling company also keeps liabilities not assumed by the purchaser. As to the tax effect, the selling company recognizes gain or loss on the sale of assets. Tax results differ depending on whether the entity being sold is a C-corporation, S-corporation or an LLC. Taxes may be part ordinary income and part capital gain, depending upon the assets sold. Additionally, the owners of the selling company may incur a second level of tax when cash or consideration is eventually distributed from the selling entity.

In a **stock sale**, the buyer has purchased stock—not assets. Therefore, the buyer gets a carryover basis in the purchased capital assets. Although there is no gain or loss to the selling entity, the selling shareholders recognize capital gains on the difference between their stock basis and their pro-rata share of the purchase price. Given the complexity of the different alternatives, it is imperative your team of advisors understands the structure and tax implications of your particular deal.

Selling the business: A pros and cons checklist

Advantages:

- A sale provides liquidity.
- The investment portfolio is diversified away from concentrated wealth.
- The estate planning process may be simplified.
- It offers the owner the opportunity to separate from the business entirely.

Disadvantages:

- The family usually loses control of the business.
- The business may pursue a different direction than the founder envisioned.
- The business may ultimately fail under new ownership.
- The loss of jobs among family members and the potential for the family's loss of identity are possible consequences.
- Future appreciation of the business is lost.

Liquidity: The thrill, the terror, the “what next?”

Comfortable, controllable and concentrated. The founding owner of a privately held business may have spent decades in the business, and everything about it feels comfortable and controllable—the routine, the risks, the rewards. Even the fact that his or her individual wealth and, by extension, the family's wealth, are concentrated in the business feels comfortable. And then one day the sale of the business is complete, and gone is the comfort, the control and the concentration of wealth.

A large liquidity event is a major life development for business owners. The initial stages of the transition can be disorienting. While they understand the advantage of diversifying their wealth away from one source, some are uncomfortable about their level of understanding of the markets, asset allocation and an investment portfolio with unfamiliar holdings over which they have no direct operating influence. Successful business owners are extremely astute people who understand the financial component of running a business, but that's not the same as knowing whether to own one stock or another, or which hedge fund may be right, or on which area of emerging markets to focus. And so many things are now out of their own control.

The segue is best viewed as a necessary mind shift, due to the liquidity event, from being a “business enterprise” to being a “family enterprise.” Along with issues of identity, there are new concerns about cash flow, investment portfolios, how family property is held and how to set up trusts, among other things. The new liquidity is an enterprise that the family now needs to manage.

The fundamental concept that newly liquid former business owners need to embrace is that when it comes to assets, concentration creates the wealth, but diversification can preserve it. Many business owners are ready to make the transition to that mindset; for others, it's a much longer process. We start with two general scenarios: wealth concentrated into a single asset or only a couple of assets vs. a more diversified portfolio. As you might expect, the best possible return in a perfect world comes from a concentrated position. But often, that potential reward has already been realized—the business itself. Conversely, the downside risks are greatest with the concentrated position. Part of the

evolving discussion is for the business owner to recognize that phase one—a concentration creating significant wealth—has already been accomplished. Our job now is to preserve wealth in the most prudent ways.

The preservation conversation naturally addresses the issue of risk. What are the potential risks and rewards of equities, bonds and alternative investments—on both an individual basis and when combined in a diversified portfolio? In many ways, the selling business owner is learning to recalculate his or her definition of risk. When they have run an operating business, or even owned and managed commercial real estate, they have a much more tangible feel for what the risk is. They are able to define clearly what a bad year or a bad outcome looks like. Figuring out risk on a diversified portfolio is not as simple. We are evaluating the risk characteristics of each asset class and then putting all that together. A business owner's definition of a 'good return' may also need a reset. A well-diversified portfolio designed to earn 8% a year over the long term may look very acceptable for most investors, but the successful business owner may think: 'I started with \$10,000 and just sold my business for \$200 million—for me, that's a good rate of return.'

On the positive side, because most business owners are accustomed to working with and understanding spreadsheets, income statements and balance sheets, they're comfortable with numbers. The CIBC Private Wealth advising team's scenarios include a lot of numbers: various types of portfolios over 10 and 20 years, assumptions about inflation, the owner's income needs, the tax implications of each scenario, and best-case and worst-case scenarios. Essentially, it's this: What might the future look like in terms of your wealth? In addition, the team must account for other illiquid assets, such as real estate owned, often creating a staged, multi-year process toward more complete diversification.

For members of a family who have been running a family business, the evolution from a "business family" into a "financial family" can feel daunting. Becoming a successful "financial family" requires more structure, more delegation and a different type of management, such as working with a new team of advisors focused on wealth preservation.

For many business owners, the transition to managing wealth involves a major shift in mindsets. Entrepreneurs who have sold their business enter an environment for which they are largely unprepared. While they often have high financial and business literacy, they often lack what might be called "wealth literacy." They feel vulnerable in a world of advisors who speak an entirely new language. Beyond that, the rules of this new landscape are complex, and it is difficult to know whom to trust. They are expected to understand the complex investment concepts and discern effectively among investment alternatives, understand byzantine fee structures and effectively calibrate risks that they don't truly understand. On top of that, families must also navigate estate planning, new tax rules and risk management strategies in very different ways than they have before.

In the face of this uncertainty, it is important to keep in mind that successful business owners have always surrounded themselves with expertise. This is no different. Our relationship with clients who experience a liquidity event includes expertise in the broad issues of multi-generational wealth strategies all the way to expertise in narrowly focused segments of investments that represent emerging opportunities. While the transition may be a long-term process, there are many steps along the way to help ease business owners into their new status as former business owners who created and realized substantial wealth.

Beyond these technical considerations of wealth management, former business owners often face substantial questions about lifestyle, how to raise their children and how to navigate the personal, familial and social complexities wealth creates. The move from business owner to wealth holder often involves a substantial change in identity. As one former CEO put it, "Last month, I was the guy who had his emails answered in 15 minutes. Now I'm the third guy in line at Starbucks." Just as the former owner is coping with this new reality, the owner's family is undergoing substantial change as well. The transition can put stress on a marriage and other family relationships. Indeed, one major concern parents face is how to prepare the children to ensure that they will not be stunted by inheritance but will grow to become wise stewards of the wealth. Here, too, CIBC Private Wealth can help. We have worked with many families to help them sort out not merely the quantitative issues of wealth management, but also the qualitative issues of inter-generational success. Through education, conferences, growing internal capability and our extensive connections with outside resources, we can help families navigate the complex realities of wealth and succession.

Selling the business: When to consider an employee stock ownership plan

An employee stock ownership plan (ESOP) is a tool that allows company employees to take on ownership of a business. They don't fit every type of business, and it's a little more complex than simply "ESOP plans let founders cash out and employees cash in," but an ESOP is a combination of letting go and keeping the business in a type of family: employees.

The National Center for Employee Ownership estimates that there are approximately 6,500 employee stock ownership plans for more than 10 million employees in the U.S. Along with millions of other employees who participate in plans that provide stock options or hold their employer's stock through 401(k)s, employees now control about 8% of corporate equity. Because they offer tax benefits, ESOPs tend to become more popular when tax rates are rising.

A main purpose of the ESOP is to provide a market for the shares of a departing owner of a privately held business. Advantages are plentiful:

- An ESOP may be a viable option for a privately held business with a lack of outside buyers or family to which to pass ownership of the business.
- There can be flexibility in structuring the transaction—the business owner can stay on and exit in phases, often providing a smoother transition for the business.
- An ESOP provides a "friendly buyer," and those friendly buyers get a new boost to motivation by sharing in ownership of the company.
- The seller can receive certain tax benefits. For example, if an ESOP owns 30% or more of company stock and the company is a C-corporation, owners selling to an ESOP can defer taxation of their gains by reinvesting in securities of other companies.* An S-corporation can convert to a C-corporation prior to the sale to take advantage of this deferral.
- Selling a minority interest in the business through an ESOP offers a way to diversify business owners' wealth, allowing them to invest in other assets.

Even with all of its benefits, an ESOP should not be entered into without an eyes-wide-open period of careful deliberation, says Arlen Brammer, a lawyer and ESOP expert in Greenwood Village, Colorado. "The first hurdle is a valuation of the business by an independent appraiser hired by the ESOP trustee. Many business owners have a valuation in their mind, which often doesn't match up with the professional, objective valuation of the business. That happens, oh, about 100% of the time. The owner/seller must be willing to sell his or her shares at the fair market value determined, even if the ESOP pays less than the owner thinks an outside buyer would."

In a typical ESOP structure, all or a portion of the company's stock goes to the ESOP, which takes a bank loan to purchase the owner's shares. The collateral for the loan is the business. "The bank is going to be very interested in how the company will be managed as it transitions from the original owner to new management," says Brammer. "It's critical for the business owner to have professional management in place well in advance of the ESOP transaction. They need a track record with the company. Management continuity is critical."

An ESOP does come with its own complexities: It can be an expensive transaction initially, requires an intensive annual valuation, and mandates additional reporting and governance. (ESOPs are regulated

by the Employee Retirement Income Security Act, which has its own strict requirements and standards, including that the company cannot pick and choose who can get stock or make allocations based on discretionary decisions.) But in the right circumstances, ESOPs can be a very satisfying way for the business owner to move forward while also giving back.

*Please consult your tax advisor to learn how an ESOP will affect your situation.



CIBC PRIVATE WEALTH

The privately held business
Pre-liquidity planning:
Before you sell that business



Pre-liquidity planning

“Start with the end goal in mind.” It’s an important prerequisite if you own a business and are laying the groundwork for selling it in a few years. But it’s not just about detailed planning for the business—your sale timeline can greatly affect your personal wealth planning goals. The same is true if you’re not the business owner but hold a significant equity stake.

In the course of a given year, thousands of private business owners sell their companies. If you expect to be among that number soon, you won’t be alone: A study done by Pepperdine University found that 49% of business owners plan to transfer their ownership interests in the next five years.³

Business owners decide to sell for all sorts of reasons. Sometimes they want to retire, monetize their asset and start a new chapter. Alternatively, there may be no one to pass the business on to, perhaps due to lack of interest or qualifications of family members or lack of a successor altogether. Or, the owner may simply be looking to diversify. No matter the reason, business owners tend to want to transition the business on their own timetable and on their own terms. Planning well in advance of a sale makes the best sense. The business itself needs to be well positioned for sale and the owner needs to prepare for wealth transformation and take advantage of planning strategies for wealth transfer and charitable giving. The earlier you plan, the bigger the opportunity set for your personal and family goals. At CIBC Private Wealth, we’ve had clients come to us just a month before the sale of a business and, while there are tactics we can help implement, they are far more limited than if we have a year or more. And if you hold an equity stake in a privately held business, you may not have much advance warning that you’re going to experience a liquidity event—the sale, after all, is not in your hands.

For either situation, two words are critical: presale strategy. Tax planning, of course, is an essential component of a presale strategy. A very thorough analysis before you sell can help you understand both the income tax and estate planning implications. We also want to have discussions about your investment strategy post-sale. If you’ve been living on the income from your business, we’ll want to talk about a strategy for using the proceeds from a liquidity event for an investment portfolio that may need to last many years. There are many issues to consider when you’re preparing for liquidity, and it’s easy to see how a business owner’s own planning can fall through the cracks. They’re often very busy wearing two hats—running the business and seeing the sale process through to conclusion.

Position your business for maximum value

Why do you want to sell? And to whom?

Every business owner thinking about an exit strategy should also think carefully about his or her long-term goals, says Michael Y. Lateef, a partner with the Hanson Bridgett law firm in San Francisco. “That’s very different from your exit strategy being ‘continue to grow the company and see what comes along.’ The strategy for the best results—for both businesses and owners—is to ask what to do to prepare for either outcome: a planned sale or an unexpected offer. The first question we ask an owner is: ‘Whom would you sell to?’ If the answer is ‘I don’t know, but I know my industry contacts, and I’ll get the word out there,’ we advise him or her to think more strategically. As a seller, you need to work on things that can make the company as attractive as possible. Much of that is internal work to get maximum value for the company.”

Lateef says that “positioning” steps generally fall into the following areas:

- **Clean up the financial statements.** In privately held businesses, expenses often are run through the business that really should not be, or loans to family members or other owners have never been paid back. Review your financials for these situations and resolve them. Get your receivables as current as possible. Financial statements should be current and, to the extent possible, prepared in accordance with Generally Accepted Accounting Principles (GAAP). Determine whether it’s reasonable to have your financial statements audited by an accounting firm or, if auditing is too time consuming and expensive, have your financials reviewed by an accounting firm.

³ Evertt, Craig R., “2025 Private Capital Markets Report” (2025). Pepperdine Graziadio Business School.

- **Verify that all human resource and hiring documents are up to date.** Review with counsel all of your employment and consulting agreements, intellectual property agreements, and confidentiality and noncompete/restrictive agreements. The business may need to secure agreements with essential employees and key management. Documents on intellectual property (IP) are particularly important, says Lateef. “In a work-for-hire state, whatever employees develop for your company belongs to the company. The same is not true for independent contractors—make sure you have the appropriate IP assignment provisions in writing. In addition, be aware that provisions you may have for nonsolicitation or noncompete after an employee leaves may be void in many states as a matter of public policy, unless they are narrowly tailored to allow a company to properly protect their trade secrets and proprietary information.”
- **Review other contractual arrangements.** Are there valuable strategic alliances and long-term contracts with suppliers or vendors? If so, you would be well advised to have those relationships locked down in writing. If the business requires real estate to operate, are long-term leases in place? If you’re the business founder, review your own documents for change-of-control incentives and requirements for staying with the company after it’s sold.
- **Improve corporate governance.** While sometimes lax in privately held businesses, good corporate governance is essential today—and to be in the best position, your governing documents shouldn’t come from free or low-cost online sites where you can simply download documents. Nor should you rely on free articles of incorporation from your Secretary of State’s office. “Really good governing documents take into account a lot of complexity that may show up in the due diligence process when you’re ready to sell,” says Lateef. “An experienced attorney can tell you exactly what you need in your governing documents to avoid unintended consequences, and what should be reflected in your corporate minutes.”

Bringing all the above up to date can add value to the business when the time comes to sell. Valuation can be dramatically affected by the failure to properly document and protect the company’s core assets and is easily corrected by advance planning. This is especially important, says Lateef, when the value of the business is based on some multiple of EBITDA (earnings before interest, tax, depreciation and amortization), common with technology and other service companies.

“A family business may use certain tactics relating to family members’ compensation or atypical expenses in order to minimize corporate tax, but in the long term, those will have an adverse effect on a company’s EBITDA numbers. And while actions to improve EBITDA are good, a buyer may be skeptical if there’s a sudden spike to the positive. The longer the runway you can put in place for your sale the better; frankly, many sophisticated buyers will expect two to three years of financials,” says Lateef. “In addition, buyers will typically require some minimum working capital requirement and will factor in the potential cost of hiring a new CEO, CFO or CMO. These functions may have been handled more informally by the owner and family members and often at less than market value, but they represent real costs to the buyers.”

Sometimes the answer to whether an owner really wants to sell is that he or she wants liquidity from the business and to move the company down to family members or long-term employees. In that case, if a third-party buyer can’t be found, an employee stock ownership plan (ESOP) or other vehicle can be used to create liquidity for the seller and pass the company on to new owners. An ESOP can be a viable option for a privately held business, offering flexibility in structuring the transaction (the owner can stay on and exit in phases, if desired) and the benefit of “friendly buyers” who are motivated, through ownership, to continue the company’s success. *(Please see our white paper “The Privately Held Business: Heading for the Exit” for more on an ESOP transaction.)*

Technology companies: special considerations

Although owners of every type of company in almost every industry sell their companies every day, technology companies seem to be the poster child for private business sales or initial public offerings (IPOs). Often, they’re bought by “serial acquirers” in the technology industry. Recently, Lateef has handled a number of sales of technology companies to foreign buyers, particularly from India and China. (If you’re a business owner and have interest from a Chinese company, please consult with an experienced attorney about possible restrictions under the Committee on Foreign

Investment in the United States, or CFIUS.) But in addition to big names already established in the technology space, companies in a variety of industries are acquiring technology companies for their products and creative spirit.

If you own a technology company, there are some specific issues you need to be aware of. Typically, says Lateef, technology companies have a lot more shareholders than other types of companies. “Most family businesses don’t have equity incentive plans as a primary, compensatory method to incentivize employees. Technology businesses really run on options—it can be the big payday for people who may not be getting paid much upfront, in part because many of these companies expect to either be acquired or go public. Going public is not something many family businesses do. So the number of shareholders can be very different with a technology company. And the treatment of various compensation plans in a tech company is something that needs thorough consideration early in the buy/sell stage.”

Consider the scenario of a buyer wanting to do a stock purchase of your technology company. The decision to structure as a stock sale can be complex but is often centered on either avoiding adverse tax consequences to the sellers that may be present in an asset sale, or perhaps because the material contracts contain assignment provisions that can be avoided by purchasing all the stock. Now consider that a 1% shareholder could hold up the entire deal. The buyer is obviously expecting to buy 100% of the shares, but it’s not uncommon for an employee or shareholder to want to “wait it out” and either try to extract additional compensation or an additional carve-out, such as dissolving a noncompete agreement.

In this scenario, there are vehicles to use early on to work around this situation. A tactic called a “reverse triangular merger” (a complex transaction that actually forms a new company for acquisition purposes), for example, requires only majority shareholder and board consent. Any dissenting shareholder hold-outs cannot stop the transaction but are instead forced to seek “appraisal rights.”

“With that tactic, the only thing to be argued about is value,” says Lateef. “And because the rules for appraisal rights are very complex, most minority shareholders either miss that window or elect to forgo that process and simply get a forced payout. The good news for a nontechnology family business planning to sell is that the shareholder count is typically quite low and lacks complicated voting structures.”

Business broker vs. investment banker

Do you need a business broker or investment banker to help with your sale? While there’s no hard-and-fast rule that you need either, it’s important to understand the difference between the two. Business brokers can be “matchmakers,” but they typically don’t have the breadth and depth of skills found with investment bankers.

“If your deal is going to be in the neighborhood of \$30 to \$50 million, you should certainly consider an investment banker—and at that size, they’ll consider you,” says Lateef. “An investment banker will pore over the financials, dissect everything and do the proper financial due diligence. More than that, he or she is often an important problem-solver between the parties. There also may be an accounting firm involved. Certainly, experienced legal counsel is required. When you package all of those resources together—people who are highly experienced in these transactions—a large deal often moves along more quickly than a small one because the professionals know what to expect and get to the meat of the deal right away. Some family businesses hire a broker, who is paid a fee if the transaction goes through, but the transaction may not always be in the seller’s best interest. A better approach we’ve recommended to family businesses is to hire a broker for a consulting agreement on specific services to help position the business for sale, for example to eliminate costs and increase EBITDA. It’s like hiring someone to stage your house for sale.” (Please see *“Putting the Business Transition Team in Place”* under the Resources section for more on building your team.)

Positioning for wealth planning strategies

As important as it is to position the business for sale to maximize its value, it is also extremely advantageous to position the family’s personal financial arrangements to maximize the benefits of wealth planning strategies. If family members are employees of the business, and part of your long-term estate planning is to make sure some of the sale proceeds go

to family, there are several ways to provide them with some equity and, as shareholders, enable them to be part of the sale and minimize the tax impact on them at the same time.

Checklist for getting ready:

Consider these steps for getting the business ready:

- Clean up the business's financial statements.
- Secure agreements with key employees, suppliers and vendors.
- Lock down long-term leases.
- Tighten corporate governance.
- Review compensation and expense arrangements of family members.

Getting yourself ready:

- Evaluate your cash flow needs post-sale.
- Discuss with your advisors the benefits of lifetime transfer strategies to reduce overall family transfer tax.
- Determine the roles of family members after the sale.
- Consider the best ways to fulfill philanthropic desires.
- Think about your life as an investor, rather than a business owner.

"Certain tactics can make a difference between the equity being treated as ordinary income or as capital gains," says Lateef. "And early planning can have a critical wealth transfer advantage as well. If there's plenty of time to plan for the owner's goals and the heirs' situation, we can often minimize the tax consequences by effecting the transfer before significant appreciation in value has occurred. Typically, early on, the valuation will be lower than at the last minute. The further in advance you can put lower-value holdings in specialized trusts, the greater the overall transfer tax savings to the family."

Depending on the structure of the sale, liquidity could be one immediate lump sum or well down the road. For a sale with plenty of advance planning time, you and your advisor should have an in-depth discussion about your lifestyle needs and how your cash flow may or may not meet those.

If you own an equity stake in a privately held business being sold or going public and you have a fair amount of advance planning time, the choices you make could be some of the most important financial decisions of your career. Actions before the assets have risen significantly in value will give you the most benefit. If you don't have a comprehensive wealth management plan, now is certainly the time to create one. Timing is extremely important to ensure the greatest leverage from placing undervalued pre-liquidity holdings into trusts. If you have a year before you believe the sale or IPO will take place, you could take steps such as exercising your shares to start the holding period and then transferring shares into a grantor retained annuity trust (GRAT), dynasty trust or a charitable remainder unitrust (CRUT). All of these tactics require a holistic look at your current and expected wealth and thoughtful discussions with your advisor. Ideally, you don't want to be in the situation where the prospect of realizing \$1 million in one day seems more of a worry than a reward.

About 30% of the business sale transactions Lateef handles are because the owner received an unsolicited offer. And it's common for the sales path with an unsolicited offer—from firm letter of intent to closing—to be as short as six to 12

weeks. “In those cases, there is very little that can be done to improve the financials,” he says. “To get maximum value and realize your own personal planning goals, surprise is never your friend.”

Minimizing personal income tax in a transaction is frequently a personal goal of the owner and the family. For obvious reasons, from a seller’s perspective, it is advantageous to structure the transaction to result in capital gains treatment, according to Lateef. It is important to consider the impact that the form of the transaction will have on the tax treatment. An asset purchase will have different consequences in a C-corporation compared to an S-corporation or LLC, including potentially unanticipated issues related to built-in gains under IRS Section 1374. Further, the timing and manner in which the purchase price is characterized can have a significant impact on the taxable income. As an example, many times a buyer will structure part of the consideration in the form of an earn-out that is conditioned in whole or in part on continued employment by the seller. *(Please see sidebar on sale structure.)*

“While a seller will want the cash at sale, and any contingent consideration to collectively be deemed the purchase price—which can be treated as capital gains—a buyer may want to offset the risk by conditioning payment on the seller still being employed by the company at the time of payment,” says Lateef. “That may be considered as ordinary income under Section 61 of the tax code and may be subject to the Section 280G deduction limitation on golden parachute payments, and would need to comply with Section 409A as well. Sellers are well advised to consult with experienced transaction counsel at an early stage of negotiations to avoid structuring issues.”

In the short-term sale scenario, many sellers have undertaken only a minimum of family wealth transition goals—setting up a trust being the most common. Prior to closing, shares can be transferred from individual names into the trust’s name. “It won’t necessarily reduce their tax burden, but the planning window is so short preclosing that it’s often the best an owner can do.”

Importantly, says Lateef, most sales now are cash-only, as opposed to deferred stock transactions or mergers. “Cash is king now—liquidity is what most sellers want. If an owner is more interested in diversification of wealth and putting in place wealth transition plans, which is common with those who’ve spent decades building a business, they’re far less interested in a sale that gives them stock in another private company hoping to go public and eventually receiving a big payout.”

Post-liquidity planning for an executive whose company has had an IPO is also important. Newly public stock may be volatile in price, thinly traded and subject to lock-ups and restrictions. In addition, an executive may want to use a 10b5-1 trading plan for structured sales of stock, which need careful consideration with an advisor to make sure sales fit within the context of personal goals and risk tolerance.

A major shift in mindset about wealth

For many business owners, the transition to managing wealth, as opposed to managing a business, involves a major shift in mindset. Often, people who sell their businesses enter an environment for which they are unprepared. Post-sale, they’re expected to understand complex investment concepts and discern effectively among investment alternatives, understand byzantine fee structures and effectively calibrate risks that they don’t truly understand. On top of that, families must also navigate estate planning, new tax rules and risk management strategies in very different ways than they have before.

A large liquidity event is a major life development for both business owners and executives in a firm being sold. Successful business owners and senior executives who’ve helped build and position a business for sale are extremely astute people who understand the financial component of running a business, but that’s not the same as knowing whether to own one stock or another, or which hedge fund may be right, or on which area of emerging markets to focus. For the business owner used to control, so many things are now out of their own control.

In addition, the family who has been part of a privately held business for many years, individually and collectively, may have been extremely business-centric. Even if they have been charitably inclined and have established a family foundation, it's often been linked to the business. For many business owners, the transition from building a business to managing wealth involves a very different way of thinking.

The challenges of a new situation, for both the business owner and for the family, are all things that you can work through with your advisor. Perhaps the most important message for owners of businesses whose goals are both the sale of the business and the achievement of their own personal goals is this: Even if you aren't planning at the moment to sell your business, you could operate under the presumption that someday it may be necessary or appropriate to sell. A similar attitude can be applied to overall wealth planning. Good planning for your wealth and your family has its own intrinsic rewards. Start early.

Types of sales—and their implications:

The sale of a closely held business can be structured in numerous ways: a lump-sum sale, an installment sale, an earnout sale based on a percentage of future profits or a sale to a charitable trust. A business owner may sell the business by transferring either the entire ownership interest (stock, partnership interest, membership interest) or just the assets of the business. The desired end result will help determine a sale's structure.

In a cash sale, in which the owner receives a lump sum of cash or property in exchange for all or a portion of his or her interest in the business, capital gain is generally recognized in the year of sale to the extent that the sales price exceeds the owner's basis, although there are exceptions.

The sale can also be an earnout. The purchase price of a business with an earnout agreement includes a contingent payment based on the company's future performance or some other matrix. The contingent purchase price is generally "earned" if certain future benchmarks are reached during a specified period after closing, and often includes a sliding scale on which the contingent payment will be made. Earnouts are typically useful when there is a gap between a seller's expectation of future profits and a conservative purchaser's estimate of the value of the business without the business owner's ongoing involvement. Earnouts may also be used to motivate and retain key employees of the business.

An installment sale can also be used, although this type of sale is more frequently considered if the business is being sold within the family. The big advantage is that it can provide regular cash flow to the departing founder. But it is best used for the sale of a stable business so that the cash flow is available for the new owners to make the installment payments.

An asset sale and a stock sale have big differences. **In an asset sale**, the purchaser acquires part or all of the assets of the selling company and gets a step up in basis on the assets purchased. The selling company also keeps liabilities not assumed by the purchaser. As to the tax effect, the selling company recognizes gain or loss on the sale of assets. Tax results differ depending on whether the entity being sold is a C-corporation, S-corporation or an LLC. Taxes may be part ordinary income and part capital gain, depending upon the assets sold. Additionally, the owners of the selling company may incur a second level of tax when cash or consideration is eventually distributed from the selling entity.

In a stock sale, the buyer has purchased stock—not assets. Therefore, the buyer gets a carryover basis in the purchased capital assets. Although there is no gain or loss to the selling entity, the selling shareholders recognize capital gains on the difference between their stock basis and their pro-rata share of the purchase price. Given the complexity of the different alternatives, it is imperative your team of advisors understands the structure and tax implications of your particular deal.

Pre-liquidity tactics:

- Transfers to trusts, family LLCs and other entities
- Gifts through grantor-retained annuity trusts (GRATs), intentionally defective grantor (IDG) trusts and similar entities
- Charitable transfers and gifts
- Tax elections such as Section 83(b), which allow a business's founder or an employee the option to pay taxes on the total fair market value of restricted stock at the time of granting
- Tried-and-true tax strategies, such as accelerating expenses and deferring income



CIBC PRIVATE WEALTH

The privately held business
Resources



Putting the business transition team in place

Business succession planning is a complex and sensitive topic. A team approach including many professionals can be very beneficial to the business owner and can minimize both disruption to the business and internal conflicts.

- A wealth management advisor, such as your CIBC Private Wealth relationship manager, can serve as the coordinating “partner” for your path through a privately held business transition. He or she will bring in expert resources, such as those described below, as needed.
- An attorney is truly a “counselor” when it comes to business succession planning. The attorney must recommend and include the legal arrangements and vehicles that are best suited for the business and the owner’s personal objectives, given the family dynamics. Attorneys may represent the business itself, the business owner and possibly even other family members, which can affect the lawyer’s independent judgment. The same conflict of interest rules apply in this situation as they do in all other attorney representation matters. The attorney must exercise caution and clearly disclose and document all potential conflicts of interest as well as state clearly whom they represent and whom they don’t.
- A business accountant has both specialized tax reporting expertise and detailed knowledge of the financial system of the business, especially its cash flows, history and profitability. An accountant typically communicates with the business owner on a regular basis and, because of this ongoing contact, will often have invaluable insights in identifying possible difficulties and conflicts.
- Because solutions to liquidity concerns often include varying types of life insurance, an insurance professional who is well versed in estate planning and business succession can be an asset to the estate plan. Consultation with multiple insurance professionals can ensure that any life insurance program is appropriate for the business owner and is competitively priced.
- A banker who is familiar with the financial health of the business and its owners or who has extended credit to the business in the past may ease the transition from a financial and business operations standpoint. A banker participating in the business succession process can advise the business owner on ways to maintain the business’s lines of credit in order to assuage the transition period and minimize the likelihood of disturbing business during a shift in control.
- A trust officer, as a representative of a corporate trustee, can provide continuity and interim control of the business during a transition period if the next generation of owners and managers is not yet ready to assume control. Sophisticated trust institutions have substantial experience in dealing with privately held businesses and assisting in business transitions.
- Valuation of the business, whether it is sold or transferred, is an essential part of the succession plan. Appraisers with a high level of expertise and experience are better able to value the business accurately and defend their valuation in the event the valuation is challenged. Sometimes it is not advisable for an accountant (even if qualified) to serve as the appraiser. A neutral appraiser, with no apparent ties to the business owner or the business, may provide the most unassailable business appraisal if there is a potential for conflict among the family members who are unhappy with the succession plan, or if there are questionable tax positions that could be challenged.
- A family communications consultant can bring additional expertise to the business succession process. This consultant may provide expertise about business management and operation, financial analysis and counseling skills, and is particularly useful in very complex succession plans. The most effective business consultants have specialized training in family business dynamics, including family relations, and are able to facilitate communication among the family members to achieve solutions that are best for both the business and the family. The consultant can overcome or avoid ethical conflicts that may affect other advisors on the team. Including the family members in the selection of the family communications consultant increases the likelihood that his or her advice will be respected and implemented.

- There is a large psychological component in a privately held business transition, both for the retiring business owner and his or her family. Consequently, a psychologist may be helpful for sorting out family dynamics. Owners may have difficulty letting go of the business they have worked so hard to build and also trouble facing their own mortality. The family and children of the business owner may likewise have trouble accepting their parents' mortality and the pressure they feel to keep the business growing and prospering. A trained professional who has experience dealing with these difficult subjects can help all parties remain rational and focused during the transition period.

Source: Adapted from "Transferring the Family Business to Younger Generations," Crady, Jewett & McCulley LLP. Used with permission.

Questions to ask before hiring a business consultant

Seven issues that you must be sure to discuss

Privately held businesses are a driving force in the American economy. They range from your neighborhood dry cleaner to enormous conglomerates. Owners of privately held businesses not only have to contend with the maintenance and growth of the business, but also they must manage the element of "family" in their operations, which introduces added complexity to the issues all businesses face—including, but not limited to, governance, growth, succession and consideration of sale.

Many families turn to consultants to help them navigate the various complexities inherent in their businesses and families. This engagement is often precipitated by an event, such as the death of a leading family member, an impasse among family leaders with respect to the direction of the business, or a change in business environment. However, many families also proactively recognize that a consultant can help them anticipate certain eventualities and plan for them in advance, so that the business, and the family, may be less disrupted.

Of course, every family and business is unique, so just as issues may range from what are commonly called "soft" or "human," such as communication, to the more technical, such as business governance and structure, there are consultants with specialties in all of these areas. Therefore, it's important that the family find the right consultant for its needs once those needs have been identified. Below are some questions and issues to consider.

Scope of engagement/fees

What will be the scope of the engagement for the business consultant, and how will the fee be structured?

As in all matters, transparency is key. It will ease the process and facilitate a more open dialogue when it's clear how the time spent with your family and your other advisors in face-to-face meetings and other communications will be billed. The same goes for the preparation of material. Again, this will depend on what the consultant is being hired to help accomplish. Some consultants charge a flat fee for the initial discovery process and then move to a monthly retainer. Others will charge a flat fee for a discrete project, while some may charge by the hour. It's important to ask, as it varies depending upon assignment and consultant.

Outlining the scope of the engagement is essential to set forth clear expectations for all parties. Not all situations will have a definable time frame, but some may. If your family is seeking help in developing a succession plan, for example, will the engagement end once the plan is formalized, or will the consultant stay on for some period of time to see the transition through?

Similarly, if the consultant is hired to review the current structure of the business, will he or she be responsible for overseeing the implementation of his or her recommendations if accepted, or will the engagement end on receipt of the recommendations? Will the consultant create an educational program for the next generation on financial literacy? Or, will the consultant host a multi-day retreat for the family to address communication issues and thereafter be "on call" for a status check or as future issues emerge? Naturally, scope and fees are interrelated, so it's important to set forth a clear understanding of both before moving forward.

Family dynamics

What's the consultant's approach to family dynamics?

Today, it's entirely possible that three, even four, generations are trying to figure out how to coexist peacefully in the workplace—from the silent generation's insistence on daily desk time to the Millennials' comfort with working from a mobile device in a coffee shop at 7 p.m. It's hard enough in any company, but the challenges can run even deeper for a family business. Given the potential impact of family dynamics on the success or failure of a business, the business owner will want to know the consultant's experience and approach to identifying dynamics that will impact the business and the family. Once identified, what's the consultant's suggested method of addressing and resolving the challenges created by the dynamics so that the family and the business may thrive?

Transition or sell

What's the consultant's experience with helping determine whether to transition within the family or sell to a third party?

Founders of privately held businesses inevitably come to the proverbial fork in the road: "What next?" Retire and pass the business to the children? Or, acknowledge that the children are neither equipped nor interested in sustaining the business? Stay on in a limited capacity? Sell to a third party? The best answer to "What next?" is usually thoughtful, long-term planning to address the many issues of business succession. It's not easy, nor do business owners always easily embrace consideration of these issues.

For this reason, this question is critical to ask of a consultant: Who should be able to lay out his or her methodology for helping to guide the planning and decision-making process? Asking the consultant for case studies or client references can be particularly useful as the consultant will likely reveal his or her approach and expertise.

Succession

What's the consultant's approach to succession?

If the choice is to transition the business within the family, you will want to know how the consultant approaches this process and what his or her experiences with the dynamic elements of it are and, importantly, how he or she incorporates education of the next generation into this process.

How would the consultant help you, as an owner, to navigate this transition successfully? If accomplished properly, it's probably the most important attribute of a successful, multi-generational family business. Again, asking for case studies and methodologies should be useful in answering this question.

Sale of business

How would the consultant approach a sale of the business?

If the decision has been made to sell, what's the consultant's experience in this process? This will typically include work with outside advisors, such as valuation experts, bankers, accountants and estate planning attorneys, to name a few. Not all consultants will actively participate in the sale, but the owner will want to know about the consultant's familiarity with the necessary steps and process and understand how and where the consultant can add value.

Wealth

What's the consultant's approach to handling the impact of wealth generated by the business on the family?

Regardless of the decision to keep or sell the business, a successful privately held business is capable of creating and

sustaining significant wealth for families. Therefore, a big part of the dynamics of families in business together is that family members, collectively and individually, are dealing with the wealth that the business creates. This wealth can present many possibilities for the family and, indeed, many are able to identify and sustain their shared and individual values through education, philanthropy and other business endeavors. Often, however, the wealth can create challenges for the family.

Some may be logistical and organizational and are best addressed by the creation of a family office, while other challenges may stem from the family's differences in adaptation to the wealth. For a family, and its business, to thrive, addressing the issue of family wealth created by the business, and how the members of the family relate to it individually and collectively, is essential. While there are many approaches to the issue of family wealth created by a business, a consultant should have a sensitivity to the effects of this wealth on the family members and a suggested approach to address it.

CIBC Private Wealth Management includes CIBC National Trust Company (a limited-purpose national trust company), CIBC Delaware Trust Company (a Delaware limited-purpose trust company), CIBC Private Wealth Advisors, Inc. (a registered investment adviser)—all of which are wholly owned subsidiaries of CIBC Private Wealth Group, LLC—and the private banking division of CIBC Bank USA. All of these entities are wholly owned subsidiaries of Canadian Imperial Bank of Commerce.

This document is intended for informational purposes only, and the material presented should not be construed as an offer or recommendation to buy or sell any security. Concepts expressed are current as of the date of this document only and may change without notice. Such concepts are the opinions of our investment professionals, many of whom are Chartered Financial Analyst® (CFA®) charterholders or CERTIFIED FINANCIAL PLANNER™ professionals. Certified Financial Planner Board of Standards Inc. owns the certification marks CFP® and CERTIFIED FINANCIAL PLANNER™ in the U.S.

There is no guarantee that these views will come to pass. Past performance does not guarantee future comparable results. The tax information contained herein is general and for informational purposes only. CIBC Private Wealth Management does not provide legal or tax advice, and the information contained herein should only be used in consultation with your legal, accounting and tax advisers. To the extent that information contained herein is derived from third-party sources, although we believe the sources to be reliable, we cannot guarantee their accuracy. The CIBC logo is a registered trademark of CIBC, used under license.

Private banking solutions are offered through CIBC Bank USA, Member FDIC and Equal Housing Lender. CIBC Bank USA and CIBC Private Wealth Group, LLC are both indirect, wholly owned subsidiaries of CIBC. CIBC Private Wealth Group and its subsidiaries do not provide, and are not responsible for, the products and services offered by CIBC Bank USA. CIBC Bank USA (Bank) will not pay employees of CIBC Private Wealth Group or its subsidiaries for referring clients to Bank, but to the extent permitted by applicable laws and regulations, the referral of clients to Bank for eligible products or services may be considered by CIBC Private Wealth Group in determining discretionary compensation to employees.

Investment Products Offered are Not FDIC-Insured, May Lose Value and are Not Bank Guaranteed.