Paying Family Members
Danny Klinefelter

A major source of friction in the family farm businesses I deal with focuses on compensation. There are a number of complex and often conflicting issues involved ranging from tax considerations to parental concerns. The issue is further compounded when there are both family and non-family members in management, and/or when some family members work in the business and some are employed outside of the business.

Craig Aronoff and John Ward, two nationally recognized experts on family owned business management, offer the following simple but very important advice to family business owners when establishing compensation policies, “Pay family members what the job is worth. If you want to otherwise enhance their standard of living or reduce your estate taxes, do it through gifting - preferably through private gifts outside the business.”

Their point is that pay involves not only money, it also conveys a message. In order to keep the message clear, Aronoff and Ward suggest thinking of family remuneration in four parts:

1. A salary or wage for the job based on its market value.
2. Performance bonuses for meeting certain predetermined objectives.
3. Profit distribution (dividend or bonus) based on company profitability to reward ownership.
4. Parental gifts for estate planning and expressions of love for family members.

Parents invite trouble whenever their motives are unclear. Some parents underpay children in order to convey a parental lesson or to control their lifestyle. Others overpay them in order to buy their dependency or to provide for their grandchildren. By not recognizing or admitting their intent, parents can create an ambiguous pay rationale. Furthermore, as compensation levels become less justifiable and more arbitrary, pressures increase to keep information secret from other family members and employees. The results will almost always be detrimental to the business in the long run because values and trust are comprised.

There are two fundamental principles to keep in mind when considering compensation for family members.

1. Separate our reasoning and actions into three categories: What is appropriate as an employee, as an owner, as a family member.
2. Make sure communications and expectations are unequivocally clear?