

“Fair but Unequal” as a Guide to Business Succession

Are some of your customers successful business owners grooming their children to succeed them? What if only some of the children are active in the business? If the business is your customer’s major asset, there may be a problem treating all of the children fairly and equally. A universal life insurance policy like Lifetime Protector Flex^{SM1} can help your customers pass their estates to their children fairly, if unequally.

Equal Split of the Business

Consider John, who owns a successful welding supply company. It is his principal asset. Two of his children, Ron and Mary, are active in his business, and will succeed him when he retires or dies. John’s other children, Susan and Bob, are pursuing successful careers of their own. John wants to be fair and is struggling with the best way to distribute his estate at his death. He is considering leaving equal shares of the business to each of the four children, but worries if he is being fair to Ron and Mary. Why won’t an equal split of the business work?

1. Seat equity: Ron and Mary have “earned” the right to succeed John, through their hard work in the business.
2. Disagreements over firm management:

Division of profits: Susan and Bob may want dividends; Ron and Mary may want to reinvest profits in the company, and pay themselves salaries.

Control of the company: Susan and Bob have never run the business, but may try to assert some control over the business once they have ownership interests.

3. Business risk:

The business may fail under Ron and Mary. Susan and Bob could lose their inheritance through no fault of their own.

The business may soar. Susan and Bob could reap a windfall on the backs of their siblings.

4. Buy-out: Ron and Mary could buy Susan and Bob’s shares to gain control of the company, but they would have to agree on a price, and a payment schedule. Ron and Mary may not have the cash, and their borrowing capacity could be limited. Besides, they may have better uses for debt than taking control of their company.
5. Uncertainty: These issues will arise during a time of great uncertainty following John’s death. Customers, creditors, and suppliers will be watching the company for a smooth transition.

In John’s case an equal split of his business is not fair to any of his children. He should pass his business to those who have earned it, and can run it, Ron and Mary. However, John should not begrudge Susan and Bob pursuing successful careers on their own. Life insurance is the

obvious strategy because it can add to the estate that Susan and Bob are receiving, allowing John to pass his business intact to Ron and Mary. Should John simply buy enough life insurance to give Susan and Bob cash equal to Ron and Mary's shares in the business? Again, that would be equal, but not necessarily fair. Why?

The value of Ron and Mary's inheritance depends on the skill and effort they invest in the business.

Ron and Mary will receive a return on their inheritance only through hard work.

The value of Susan and Bob's inheritance is fixed, does not depend on any effort from them to retain its value, and generates a return through passive investing.

The Life Insurance Strategy

To be fair, John may consider applying a discount to Susan and Bob's inheritance. How large a discount depends on John's values, the needs of his heirs, and his own sense of fairness. Every case will be different. Why should he use a universal life insurance policy to fund the inheritance?

1. Universal life insurance lasts as long as John lives, provided he continues to pay premiums sufficient to keep the policy in force and the loan balance does not exceed the cash surrender value.
2. Adjustable benefits: John can decrease or increase (depending on insurability) the death benefit as his business grows and as the needs of his heirs change.
3. Flexible premiums: John can pay premiums at whatever level his budget allows (subject to paying sufficient premiums to keep the policy in force).

Many believe that equal means fair, but that is not always the case, especially in estate planning. Think of Lifetime Protector FlexSM as a possible solution allowing your customers to treat their heirs fairly, when they can't treat them equally.

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