

WILLS, CHARITIES, TRUSTS & ESTATES

'Equal' isn't necessarily fair in estate planning

By Nancy Graham

Your clients have come to you to update their will. Like many parents planning the transfer of assets to their family they tell you "we want our children treated equally." Their goal is clear — we all believe equal treatment will ensure peace between our children.

But like many well-intentioned wishes, this can create some thorny issues. Assume that your clients have a business that has successfully provided for the family and employs 50 people. They own a city home, a cottage and a significant investment portfolio. Your clients are an active couple in their 60s with two adult children and five grandchildren. This family often spends time together with the grandparents at their summer home.

One child works for the family business, while the other has never participated in the firm and has declared "no interest" in joining it now or in the future. Your discussion naturally migrates to the transfer of the business to the active child with other assets to benefit the second child. Such a solution avoids potentially contentious issues that arise when the second child has significant value tied up in a business that does not interest him or her, and the active child has to share the profits of a business to which the second child has not contributed.

Since your client's business is conservatively estimated to be worth \$2 million and the balance of the assets is believed similar in amount, this sounds like a good split.

The task for a financial estate planner working with legal counsel now becomes one of determining what this "equal" split produces and whether it is actually fair.

Careful consideration of the assets being divided is crucial. If the business is specifically directed to the first child, the second child who is left the residual of the assets in the estate bears all the income tax and estate settlement costs. Where there is significant tax to pay, the second child may inherit a lesser value than intended. That is not fair.

What about the nature of the assets themselves? The first child may be acquiring a significant value in company shares that has a low tax cost as a result of your previous estate freeze.

Taking over the business also requires the first child to provide large personal loan guarantees and a significant dedication of the new owner's time to realize on the company value.

By contrast, the inactive child calls a real estate agent, sells the city home, adds the cash proceeds to the investment portfolio and enjoys another summer at the family cottage, now a personal asset. At a certain point, the child active in the business might be willing to forego the business for liquid, tax-paid assets.

The "fair" allocation of property goes beyond estimating market values and dividing this value in two. The income tax implications, the liquidity considerations and the business or investment risk of significant assets need to be considered. As professionals we can help the client evaluate these issues.

The emotional value of assets is also very important, and soliciting the clients' insight into how much the family home or cottage might weigh on the "fairness" scale can be crucial to family peace. Financial estate planners know through experience that some assets that are economically minor can be priceless to family members.

When the weighing and measuring is done, the allocation of assets may need to change to achieve the "fair" distribution. What choices do you have to honour your clients' wishes? Do you leave less value to one child? Can you isolate and segregate some asset or activity of the business, directing it to the child getting less? Do you establish a "frozen" block of share value for the inactive child that must be paid out in a certain number of years, thereby handing the financing of your client's equalization wish to the next generation? Is this "fair"?

What about clients financing this themselves? A joint-last-to die insurance policy might solve a suite of problems. Such a policy — assume your clients are a 65-year-old male and 63-year-old female — can be purchased for a financing cost of as little as one per cent a year and may provide a simple, clean solution that achieves client goals and results in the much-desired fair split and family harmony.

Considering these factors means you have raised issues your client will not have imagined, guided their thinking to a solution and achieved fairness. The most important benefit is your client has the comfort of knowing they have treated their family fairly and protected important assets.

Six guidelines

Six straightforward guidelines will help legal counsel achieve clients' wishes for peace—and your clients will thank you for it!

1. Give your clients the information they need. Parents often need help with determining what is fair and equitable and what steps to take to achieve this.

2. Involve your client when developing the "emotional balance" sheet. Probe to determine assets that may be emotionally valuable but may not show up on the financial balance sheet.

3. Involve other professionals. The accountant can establish the tax balance sheet and identify and help transition business imperatives like loan guarantees.

4. Use your relationship with a financial estate planner to identify and quantify the issues and develop solutions that work.

5. Just the facts. Clients benefit from seeing the actual monetary worth of their assets and the costs of their transfer determined by an objective professional.

6. Ensure your clients have clear information and make and implement decisions to achieve their goals. The plan only works when it has been executed.



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