The Human Element of Succession Planning

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In the February 2006 issue of *MoneySaver*, my column on succession planning told the disheartening tale of the late Joe Business (1945-2005), a successful entrepreneur whose assets included:

- a $20 million dollar company,
- $650,000 equity in his $1 million home,
- a mortgage-free $500,000 cottage,
- $250,000 in non-registered investments, and
- $125,000 in RRSPs.

Yet his estate ended up $2.6 million in debt after Joe died unexpectedly and without proper succession plans.

The sequence of events that left Joe's estate deeply in debt were more than a business disaster and a feeding frenzy for the tax collector. This was also a human tragedy. As of the spring 2006, Joe's family has lost its cherished cottage, his eldest son is seeking a new career, his disabled daughter is on welfare, his second wife is working part-time, his youngest son expects to rely on student loans when he reaches university, and his 80-year-old mother has moved from her upscale retirement residence to a county home for the aged.

The business moral of the story can be found in the February issue, i.e. good planning, with an estate freeze and some custom-designed insurance policies at the centre of the strategy could have led to a vastly improved outcome and left his estate in the black.

In this issue, the focus is on some of the important human and family issues that Joe's succession planning should have dealt with—including the cottage and the details of the support for people who expect to continue to rely on the assets Joe acquired during life.

The Family Cottage

The family cottage is often one of the most difficult issues for succession planners to deal with because of the emotional entanglements of the children and the complexity of finding an equitable and happy solution for all concerned.

Sometimes, people's apprehension about opening up a can of worms by discussing the future of the cottage is enough to stop them from starting to make vital plans that will protect assets for the next generation by deciding in advance how the capital gains tax will be paid.

In Joe's case, he'd bought a cottage in Muskoka in 1973 for $50,000. By 2005, it was worth $500,000 and Joe's estate owed $103,500 in capital gains taxes. The cottage was the first thing to be sold—the best assets always go first—and all the proceeds went to paying off the estate's debts.

Succession planners can help resolve the problems surrounding the family cottage. Sometimes, innovative solutions include turning over the cottage to the children early and letting them share the capital gains taxes. In other cases, it's more expedient to take out an insurance policy that will cover the cost of the capital gains tax when the parents die and the cottage changes hands. If the children pay the premiums on the insurance policy, keeping the cottage doesn't reduce the retirement income of the parents while ensuring that the cottage will stay in the family's hands.

Joe's Eldest Son's Career

Joe's eldest son was working in Joe's business, learning the ropes from the two senior executives who expected to stay on with the company after Joe retired. In our case, the company had to be sold and the executives moved to the competition. There was no business for the son to run.

Succession planning can deal with these issues effectively. A business plan that includes "golden handcuffs" designed to keep key executives from leaving and a contract for the son that keeps him in a "learning" role for a number of years can do a great deal to ensure the survival of a company.

The succession plan also has to deal with the two children who are not in the business but expect a fair share of the assets. Often, it's better all-round to leave the business to the children involved in it and find other ways to compensate the children who aren't. Some children will be interested in seeing the company prosper and grow, reinvesting profits; other will see the profits simply as disposable income for themselves.

A solution based on insurance can work. With insurance policies paying the non-business children an amount equal to the discounted value of the business on Joe's death, the business can be fairly and equitably left to the children who are involved.

Joe's Dependents

Joe's lack of planning had an immense impact on his dependents, including his disabled daughter, his young second son and his elderly mother, and, of course, his current wife.

Joe died without a valid will. He had not updated his will after remarrying and under Ontario law, he died intestate.

A valid will would have simplified things for his wife. The cottage, the house, the investments and the RRSP could all pass to her tax-free. Even given the disastrous results of the business estate, she would have had considerably more after Joe's death.

Because Joe had no valid will, under Ontario rules, his wife inherited the first $200,000. The remainder of the estate was divided with one-third to the spouse and the rest equally divided among the children.

In Joe's case, with a valid will and proper business and personal succession planning, the family would have been well-off financially after Joe's death. A well-designed succession plan could have taken some extra steps to ensure the comfort and security of the three most vulnerable people in Joe's life—his disabled daughter, aging mother and very young son.

In Joe's worst-case scenario, his wife had to get a job to support herself, and not in the style to which she had been accustomed. His oldest son's career trajectory was diminished because he lost the advantage of working in a family-owned company. His youngest son depended on the public trustee for some support and had to get student loans to complete his university education. His disabled daughter ended up on welfare in public housing and his aged mother moved from her luxury retirement home to a county facility. It was a human tragedy as well as a business one.

Where did Joe go wrong?

There are some lessons for other business owners in Joe's experiences.

Joe's biggest errors were not rewriting his will after remarrying and not preparing for the tax implications of an unexpected accident that would remove him from his business. What happened to him was that his principal advisors, his lawyer and his accountant, were old buddies from Joe's early days. They always had a good time together and business discussions were informal.

As Joe became more successful, he outgrew his buddies without realizing it. Instead of working with lawyers and accountants whose practices were made up of successful business owners, he was dealing with advisors who weren't accustomed to the kinds of challenges that he faced.

Business owners, as they become successful, should take every opportunity they can to meet with people who are in similar situations. It's in discussing the challenges with your peer group that you find out how to get the advisors you need. You may never realize that you need a tax specialist until you hear how that kind of advisor has helped a colleague.

The second lesson Joe can teach us is that you are making a mistake by waiting to "get all your ducks in a row" before you start to make plans.

Joe's lawyer told him that his will had to be rewritten, but Joe kept putting it off. He was too busy to get into the complexity of sorting out the cottage and the business between two families. And he had the feeling that making a new will when he was no longer a young man would somehow trigger bad luck for him.

Actually, there's no better way to get all your ducks in a row than by sitting down with competent advisors and going through your entire situation. You may believe that your universe is unique and incredibly complex, but an experienced estate planner is likely to have seen it all before. That planning experience can help you find a way to line up your ducks and create equitable solutions that will set your mind to rest. Chances are good, you will have a lot more time for thinking about developing your business once your plan is in place and those unresolved issues aren't distracting you.

This column is an opinion column. If any of my opinions are of value to you, please make use of them. If you disagree with me, please don't take offence.

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