THE BISHOP COMPANY, LLC

Making insurance understandable

Achieving estate equalization (and peace and happiness) through life insurance

Here's an all-too-common scenario that bedevils estate planning for many a well-intentioned family business owner: The business has prospered, though not all the children participate in its operation. How does the owner equitably divide the estate—which may consist primarily of the family business, an illiquid asset—among the heirs once he or she dies?

The easiest thing to do would be to split the pie equally and let the heirs work it out, but that strategy rarely makes anyone happy. When the family business is the largest asset, dividing it equally is unfair to those heirs who are involved in running it, and unfair to those heirs who would prefer to receive the cash value of the business.

Estate equalization through life insurance offers a solution. Essentially, the business owner uses life insurance to provide those heirs not involved in the business with an equitable inheritance. Leaving the business to the active children and life insurance (owned by an irrevocable trust) to the inactive children divides the value of the estate equitably among all the children.

Estate equalization avoids two messy outcomes that can result from splitting the business equally.

Messy Outcome #1: The children actively involved in the business may be obliged to purchase the interests of the inactive children, which may not be a financially viable option at the time.

Messy Outcome #2: The children who have not been involved in the business suddenly find themselves playing an executive role in an enterprise they are not interested in (nor likely capable of) managing. Tension between the new business partners is virtually guaranteed.

A simple example:

Bob's family business is valued at $4 million. His estate includes $2 million in other assets, such as real estate and securities. He has two children: Pam, who works for the family business and is being groomed to run it once Bob is gone, and Don, who chose to pursue a different career. Splitting the existing pie equally would provide each child with a $2 million stake in the business and $1 million in liquid assets, but it gives neither child the inheritance that suits their situation.

Solution: Bob takes out a $2 million life insurance policy that pays out to Don upon Bob's death. Don receives the proceeds from the insurance and Bob's other, non-business assets, and Pam receives the full interest of the business. Each child thus receives $4 million from the estate—a settlement that is both equal *and* equitable.

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