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Why life insurance matters in succession

Farm transition specialist Ray Riel discusses what different types of insurance can and can't do for a family and business

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Farm families should examine the different types of insurance available that can protect them from risks present at different stages of life. Photo: Thinkstock

In a previous edition of *Farmtario*, we spoke with farm transition professional Ray Riel about why young farmers should have a last Will and Testament. In this instalment, Riel expands on estate planning by delving into life insurance.

We asked Riel to explain how and why farmers of all ages should ensure they have the right type of life insurance for their current business and family circumstance.

Why it matters: Life insurance can be affordable considering the benefit received in the event of death. That benefit can save a farm further family trauma and help with succession.

Q: Why is it important to consider different types of life insurance in succession planning?
A: Different types of insurance protect you from different types of risks at different stages of your life. Different types of insurance will have vastly different premiums.

There are two fundamental types of insurance: term insurance and permanent insurance. Term lasts for a specific period of time. If you die within the period covered, your family receives the benefit. If you were to die after the period expires, no benefit is paid.
Permanent, on the other hand, covers your entire life. Permanent insurance is more expensive in terms of premiums, since the insured's family is guaranteed to receive the benefit regardless of when you die, even if you were to live to age 110.

Q: What type of insurance should I look at if I'm younger, or still in the midst of my farming career?
A: Term insurance can be the answer for younger farmers, since they can incur significant debt earlier in their farming career, have additional family responsibilities, and premiums can be reasonable.

For example, if a 35-year-old successor (in average health) were to acquire a 25-year term life insurance policy, with a $1,000,000 benefit, their premium cost would be locked in at about $75 to $80 per month, for the entire 25-year term.

Upon the death of the insured, term insurance benefits can be used for any purpose the surviving family decides appropriate. For example, benefits can be used to pay down farm debt and ensure their children's future education or other needs are looked after.

Benefits could also be used by a surviving spouse to pay for hired help, or to hire a farm manager, so that the farm can continue operating until a successor's child is old enough to assume more farming responsibilities. Ultimately, term insurance provides surviving family members with options. Without an insurance benefit, sometimes the only viable option is for the surviving family to sell the farm.

Founders also may wish to consider what might happen if their successor died unexpectedly. A good farm transition plan needs to consider that possibility. If a successor's spouse is uninterested in farming and their children are too young to continue the operation, what happens to the farm?

Founders could consider term insurance on their successor, to provide them with the means to purchase farming assets from a surviving spouse and keep the farm intact for perhaps another family member. Again, term insurance benefits can provide surviving family members and founders with options.

Successors should also consider term insurance on a child's care-giving parent. If something happened to the spouse, funds will still be needed for care givers, education, etc.

Q: Will a successor need insurance when they get older? What should they consider?
A: As we get older, farm debt and family responsibilities typically decline. If we are successful in our farming careers, we accumulate assets. Sometimes those assets have risks associated with them, so permanent insurance may be a solution.

For example, successful farming operations often are incorporated, and when excess liquid cash accumulates in an operating company, an accountant may recommend a farmer set up a holding company for that excess cash. This is to preserve tax-free rollover options for the farm operating company.

However, tax-free rollovers to farming and non-farming children are not available for funds in holding companies, and there can be significant tax consequences for those funds. Permanent insurance premiums, although expensive, can be less expensive than the tax liability. The calculations are complex. It's best to rely upon your chartered professional accountant to help you make that determination.

As successors get older, estate equalization becomes a challenge if there are both farming and non-farming children present. In farm transitions, farms can be partially sold to a successor, and partially gifted both to a successor and their non-farming siblings.
Gifting land to non-farming children can bring management challenges and tax complexities. Both are best to avoid if possible.

Life insurance benefits can be used to help alleviate those challenges.

A successor with some forethought can have the best of both worlds (first term, then permanent protection) by purchasing a 25- or 30-year term policy that is "convertible" – which simply means that, prior to the end of the term, a successor can convert their term policy to a permanent policy without proving insurability. This means even though a successor's health may have deteriorated significantly during the time they owned the term policy, they can convert it into a permanent policy without having to prove health status.

Q: You've mentioned lender insurance in the past. Can it be useful?
A: Lenders make it easy and convenient to acquire loan insurance by filling out a simple questionnaire in the lender's office. Like term insurance, the premiums remain the same until the loan is paid for. Unlike term insurance, lender's loan insurance benefits are generally structured to pay only the outstanding balance of a loan. The benefit might not amount to much if the loan is almost fully retired.

A lender's loan insurance benefit is paid directly to the lender, whereas a traditional life insurance policy benefit is paid directly to the successor's beneficiaries named in their policy.

To acquire a traditional life insurance policy, a successor must complete a detailed medical questionnaire, and sometimes depending on successor's age and the amount of benefit required, may have to undergo a brief medical exam. Once the application is approved the successor's family is guaranteed to receive the benefit if the successor were to die (unless it were by suicide within two years).

Although the application process for term or permanent insurance is more thorough, premiums are generally less than a lender's insurance, and the benefit can be significantly greater.

It's important to do comparison shopping before signing onto your lender's insurance offering. An easy way to compare rates is to go to www.term4sale.ca . Names and addresses are not required. No salesperson will call unless you want them to.

Q: These are all personal options – an individual holding a policy for themselves. Are there other options?
A: If a farm is incorporated, a farm corporation can acquire a policy on a successor. However, a successor would be well advised to review the strategy with their accountant and their lawyer, prior to acquiring corporate owned insurance to ensure that complexities with CRA are not incurred, and benefits flow to the proper beneficiaries.

Q: You've been working in successors in farm transitions for a while. What proportion of your clientele has some kind of life insurance?
A: It's pretty common. Roughly, I'd say about 50 per cent of successors have some type of life insurance in place upon starting their file, and probably closer to 80 or 90 per cent of them will acquire insurance by the time we are done working together. Often times successors simply don't realize how relatively inexpensive life insurance can be, and how it can save a farm for the next generation.

ABOUT THE AUTHOR

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Matt is a freelance writer based between Essex County and Chatham-Kent. He is interested in all things scientific, as well as rock n' roll, hunting and history. He also works with his parents on their sixth-generation family farm.