

THE ACADEMY OF ELECTRICAL CONTRACTING

**Paper Presented by
Wesley S. Harkonen, Fellow**

EQUALIZING THE INHERITANCE
An Addendum to Succession Management

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As many members are aware, handling the succession to one child of a family-owned business can be especially difficult when you try to offer fair value to a child who chooses not to follow your footsteps into the family business. This was our situation back in 1982, when our younger son, Tim, expressed a desire to work at Lakehead Electric.

The corporation had been successful, and my wife and I had been able to send both our sons through college. The elder son, Scott, graduated with a degree in medicine, while Tim minored in engineering and majored in business economics. Tim had worked for two years in a management training position with General Electric before he approached us thinking about a future with Lakehead Electric.

Certainly, we were pleased that either of our children would want to follow us into the family business. But what were we to do about equalizing the inheritance for the future of both our sons?

Luckily, at about the same time, we had been in discussions already with our estate planning attorney due to changes in the tax laws affecting inheritance. Since we were making changes in our estate planning to take into account the law changes, it occurred to me to try and come up with a “formula” for establishing a basis value for the corporation, which could be equalized between the two sons even though one was entering into the business and one was not.

We arranged a meeting among our two sons, the corporate attorney, the estate planning attorney, and our personal and corporate CPA, to come to an agreement. We discussed many components of the overall state of affairs: both boys had at some point or another worked in the shop during the summers; both had been college-educated at different levels of “investment;” Tim had benefited from two years of management training at GE; and so forth. Taking all of this into consideration, plus the fact of Tim’s new employment at Lakehead Electric and the training experience he would undergo there, we concluded that after three years, Tim would be contributing to the growth of the company, and at that point, the corporate net worth would begin to change due to Tim’s sweat equity in the business.

We agreed that when Tim’s “training period” ended after three years on the job, the value of the business at that time would be used as the basis. Everyone, including Scott, agreed that this was a fair determination of value.

Tim entered the business doing estimating, primarily. He began working within our then-major market, estimating traffic signal and street lighting construction. At that time, Lakehead Electric did ninety percent of this type of work in Duluth, so it was an excellent training ground for him.

At the pre-determined time (after three years) for evaluating the basis of the company, we called another meeting similar to the first. Incorporating our gifting of shares (to both of our sons at that time) medical school education costs versus engineering school education costs, etc., we arrived at a figure for what the equal inheritance would be should something happen (my or my wife’s deaths) necessitating its determination.

At that meeting, we also decided on a schedule of payments for Scott, with the understanding that he would have no claim to the anticipated future growth of the company. From that point forward, we have been making sure that everyone has been fairly compensated over time for the value of the family business, and Tim had great incentive to continue to assure that the business grew as he gradually became the major stockholder. His contributions to the business over time have been tremendous, allowing the corporation to grow and diversify into both the paper mill industry and the mining industry. Scott, on the other hand, is content with the valuation of his inheritance based on the level to which his mother and I had brought the company, plus Tim’s training period within the business.

Shortly after that second, 1985 meeting, Tim was made President and CEO of Lakehead Electric, and fifteen years later, with the business increased seven-fold, we sold Lakehead Electric to an outside buyer in 1997. The corporate name went with the sale, and Tim has stayed on as President and CEO, due to the contacts he’s developed over the years, the reputation of the company, and the overall goodwill we’ve established in the industry. In addition, the company is further diversifying into the datacom industry, and all is

going quite well for everyone.

For my part, I now have an office and a “consultancy” within the business. But this is the beginning of my retirement, and we are all very pleased with the overall outcome of the succession.

If there is one piece of advice I would like to pass on to others who might find themselves in a similar position, it would be this: Secure a knowledgeable estate planning attorney to help you through the process. Deciding on what point at which you will determine the value of your business for inheritance and gift purposes is only the first step, although it is a major one which causes some perplexity. The second steps will be to plan a schedule of compensation for the family member or members who elect not to become involved in the business, and for that, I highly recommend the advice of an experienced estate planning attorney.

Looking back on the entire enterprise, I cannot say that I would change a single item of the overall plan. It has worked amicably and efficiently for all of us, keeping not only the company but the family together, assuring the growth of the business, the satisfaction of our children, and the secure retirement for my wife and myself.

Wesley S. Harkonen, consultant to Lakehead Electric Company, Duluth, Minnesota, first became involved with NECA as the NECA Representative for Collins Electrical Construction in 1958. He has served the Twin Ports-Arrowhead Chapter as Governor, President, Vice-President, and Treasurer, and was on the Board of Directors for 21 years. He served on the NECA National Marketing Committee in 1994 and 1995.