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SPECIAL REPORT

Business Succession Planning

Want something to pass along or sell? You'd better insure it

GUEST CONTRIBUTOR

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Many business owners consider their biggest assets to include tangible items such as: buildings, inventory, vehicles, etc. However, it is the owners and key employees that are the most valuable and impactful to the company's bottom line. What would happen to the company should an owner employee become disabled, want to retire or have an untimely death? How can you protect your business's most valuable asset? The answers to these questions must be part of your overall risk management.

Areas of consideration to the prudent business owner:

– **Buy/Sell Agreement** – Retirement, death, disagreement and disability tend to be the most common withdrawal events found in buy-sell agreements, but corporations are not limited to those. As residents of California, we are subject to community property law. Thus, if you are in business with one or multiple partners and they die, you become partners with the decadence spouse or their heir(s). They may or may not be qualified to efficiently run your business. More commonly they will expect "payment" for their spouse's or parent's shares of stock. Having a current, written buy/sell agreement is critical. Furthermore, it is vital that it is funded with life insurance and / or disability insurance. The first step is to determine a valuation of your business. There are multiple formulas you can employ and often a CPA is consulted. Upon agreement on a value, you divide that amount appropriately by percentage of ownership and that is what each owner should be insured for to satisfy this need. For companies that have one business partner, a "cross purchased" strategy works well. For example, Partner A would own a policy on Partner B who is the insured. Partner A pays the premium (does not deduct the premium keeping the benefit free of taxation) and is the beneficiary of this policy. You also will receive a "step up" in cost basis when you utilize this strategy. For multiple partners, it is best to employ a stock redemption strategy. Under a stock redemption plan, the corporation redeems the shares of the withdrawing stockholder. To fund the redemption (pay the withdrawing shareholder), the corporation typically uses the proceeds or funds it owns as both owner and beneficiary of a life policy insuring each stockholder. Thus, the corporation purchases one policy on each shareholder. The other types of agreements include: "one way agreement" for sole proprietors and the "wait and see" agreement.

– **Disability Insurance** – According to the National Safety Council, in the U.S. a disabling injury occurs every 1 second, a fatal injury occurs every 4 minutes. What would happen to the capital of your business should you become disabled? You can provide protection to your business with a "business overhead expense" policy, creating an influx of cash enabling your business to continue running. You can also purchase personal disability policies that will pay you, the insured, an income stream that would integrate with social security benefits protecting your ability to finance your life style by replacing your paycheck. You can also fund buy/sell agreements with disability insurance.

– **Key Employee Insurance** – Certain key people within your organization are critical to your business's overall long term success and profitability. Without one of them, the value of your business could be negatively impacted. Developing an insurance program to protect against a potential interruption during the absence of a key employee just makes good sense. Life Insurance is a great way to protect against the loss of a key employee. However, it doesn't have to be the only way. Purchasing disability insurance for your key employees can provide them with income from a source other than the company if they become disabled, freeing up cash flow. Nonetheless, be careful on who pays the premium and if there are deductions made of premiums as it could expose the benefit to taxation.

– **Long Term Care** – Unplanned for long term care events are one of the major reasons people lose their assets. National average for a Nursing Home Facility is $6,023 per month, But the Sonoma County Average is $9,256 a month, according to a report by the National Alliance for Care Giving in the U.S. and AARP. Why "spend down" your assets when you can leverage and protect your portfolio with long term care insurance? If you are a C Corporation, you can elect to only cover yourself and your spouse (even though he/she may not be employed by your company), deduct the premium 100 percent as a business expense without making the benefits taxable. For other types of business entities, other tax benefits do exist. If your purchase a policy individually, and the premium added to your other medical related costs exceeds 7.5 percent of your adjusted gross income, you too can begin to deduct a portion of the premium.

Business Insurance is an effective and simple way for successful business owners to protect the value of the business. Implementing a pre-planned, customized strategy to mitigate the financial impact created by the loss of an owner or key employee, business owners can protect their life's work and financial future.

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