BUSINESS LAW REPORT

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USES OF LIFE INSURANCE IN BUSINESS PLANNING

By Jay D. Fullman, Esq.

Businesses must engage in appropriate planning to succeed. Businesses can use life insurance in different ways to help meet their objectives, including the following:

1. Basic Employment Benefit
Many companies provide their employees with life insurance coverage as a basic employment benefit. Any employer can provide its employees with Group Life Insurance coverage of up to $50,000. The benefits help the family of the employee pay funeral and burial costs, estate administration expenses, and adjust financially to the loss of the wage earner. The insurance premium paid is tax deductible by the employer and not taxable income to the employees. The premiums are almost always substantially lower than the premiums for individual life insurance coverage. An employer can also provide insurance above the $50,000 level, with only a partial income tax effect on the benefited employee.

2. Executive Employment Benefit
Companies may offer executive employees the benefit of larger life insurance packages, such as life coverage of $1 million, or more, and cash value accumulations. This is usually done through a Split Dollar Life Insurance Agreement. In a split dollar arrangement, the premium is split between the employer and the employee. The company usually advances the premium payment, and issues a form 1099 to the employee for the premium paid on the employee's behalf. To sweeten the arrangement, the employer might also pay a bonus to the employee to cover the employee's premium.

3. Owner Buy-Sell Agreement
An owner buy-sell agreement, or cross-purchase agreement, is a contract between the business owners (partners, shareholders, or limited liability company members) to purchase the ownership interest of an owner who dies before retirement. The contract is usually funded with life insurance. The owners purchase life insurance on each other. The benefits of the arrangement are: (1) gives the owners money to buy out the interest of the deceased owner; (2) prevents family of deceased owner, or outsiders, from interfering with the business; (3) minimizes cash drain on the business; and (4) the deceased owner's heirs receive the value built up in the owner's share of the business. The value of the deceased owner's interest in the business can be established by the amount of the life insurance coverage, or the value of each owner's interest can be separately calculated and established.

4. Entity Buy-Sell Agreement
An entity buy-sell agreement, or stock redemption agreement, is an arrangement between the company and its owners that allows the company to buy back the deceased owner's interest in the business. This works like a cross-purchase plan, but the company owns the insurance and buys the deceased owner's interest (instead of the surviving owners buying the interest). The benefits to the company and the deceased owner's family are the same as with an owner buy-sell arrangement.

5. Key Person Insurance
The company may purchase insurance on the life of a key employee. The company becomes both the owner and the beneficiary of the insurance. The insurance proceeds paid will help the company adjust financially to the loss of a crucial employee.

6. Deferred Compensation
A deferred compensation plan is an incentive plan in which an employer promises to pay a valued employee a certain amount of money at a future date (usually at retirement). By funding the plan with life insurance, the company will (1) have a means of obtaining the funds necessary to pay the employee's heirs if the employee dies before retirement, or (2) be able to use the accumulated cash value in the life insurance policy to pay the employee the agreed deferred compensation upon retirement.

This is only a brief summary of different uses of life insurance in business planning. If you desire specific advice, please contact Jay D. Fullman.