Episode #219: 4 Ways Business Owners Can Leverage Life Insurance

Video Transcription

Welcome back. My name is Kyle. Today, we're going to be talking about the four ways business owners can leverage life insurance.

As a business owner, you've done a great job and poured your heart and soul to make sure your business is a success. But what you probably didn't know is that life insurance can play a pivotal role in making sure your business continues to thrive in the future.

Now, whether that's a transfer of ownership issues or concerns littered on the road, or simply retaining and rewarding top talent at your firm, we'll dive into those four strategies today and look at through the lens of both the business and the employee and how each one of these works.

The first one is what we call a buy-sell agreement. In other words, a business continuation plan. It's a legally binding contract between the owners of the firm, typically, more than one, of course, where we're using term insurance or permanent insurance as the funding vehicle. By doing this, inside that agreement is what we call a triggering event.

Most of the time, when death, and illness, termination, or retirement takes place between an owner, we're going to use the proceeds from the death benefit that the other owners can use to buy out that former owner's interest and pay off that deceased interest and that estate. By doing that, we're able to prevent any forced liquidation and keep that ownership in-house.

Not sure about you, but I wouldn't want to be partners with my former partner’s spouse. So this is definitely something to consider, and again, keep ownership in-house and the importance of having that.

At the same time, what it will do is create a ready market for the business at fair market value and allow those other owners to step up in basis, creating additional value for them as they take on over that additional equity from the former owner.

The second one is what we call a non-qualified deferred compensation plan. All this is is an insurance-based retirement plan that the corporation owns on behalf of the employee to really retain and attract your top talent at the firm. Now, I put an asterisk mark here, as far as benefits for the organization, they're not going to get an immediate tax deduction, however, it's going to be delayed.

This is a deferred comp vehicle. The corporation has a future obligation to pay out those benefits, at that time, then they will receive that tax deduction from the firm. However, during that timeframe, we will be able to allow this policy to become an asset on that company's balance sheet. It's a win-win in both scenarios.

The best part about it is that this does not fall under the limitations of ERISA, or the IRS approval. We don't have to spend all the money and all the paperwork to implement one of these types of strategies. From the employee standpoint, it's great for them, because they know that if they stay with the business at retirement, they're going to get some benefits; of course, they will be taxable to them.

But it will just supplement what they already have been contributing towards and that's likely a 401(k). This is great for those types of select employees that are looking for additional ways to generate wealth, and have that business be able to offer.

The third and the easiest one to implement is key person insurance. We're simply just using term insurance. All we're doing here is ensuring our top talent at the firm, where if that individual passed away, we can help offset that financial loss and use the proceeds to find a replacement.

There's no tax-deductible aspect to this type of plan. The employer will be paying after-tax dollars to fund one of these strategies, not so much benefit for the employee. In this case, they may get additional coverage during retirement after they've done their years of working with that firm.

But the last one, and I think most important is what we call an executive bonus. This is another easy-to-implement type strategy where we're recruiting, rewarding, and retaining our top talent to the firm. I underlined retain because we can have an attorney draft up what we call a vesting schedule, which really restricts their access to the policy.

Unlike a deferred comp plan, the business for executive bonus gets an immediate tax write-off, because the bonus that they're paying a premium for the insured or for the employee in what we call reasonable compensation.

So that is an entire tax deduction to the firm. Freedom to favor, so we can be a little bit more discriminatory. Similar to deferred comp, it's typically for those C-suite top executives of the firm and only those types of people. Best of yet, no IRS approval, implementation is very easy in comparison to other ways you can do so.

From an employee standpoint, how does it work for them? Well, they're not paying any form of premium towards the policy. The only cost to them, hence the asterisk, is the tax that they receive on that bonus. You just have to be mindful of that. It could bump you up into a higher tax bracket.

But at the same time, since they own it, it becomes portable. Whether they wait until the end of the vesting schedule, they're the owners of the policy, and until they hit that threshold, if there is even a vesting schedule included, they can take this policy, and move it, and use it, and access that cash value on a tax-free basis.

We talked about the four ways, buy-sells, deferred comp, key person, and executive bonus, and it's hard. I can imagine, it's hard to think about losing a partner of yours as an owner, or a top individual on your firm. But we have to prepare for that gloomy day.

So, I ask you to reach out to the financial advisor that shared this video and see if one of these strategies is appropriate for you and your firm.

Thanks again for tuning in. Have a great day.