

CONSIDER THE IMPORTANCE

Minding Your Business Owners

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For many business owners, their company represents far more than just a source of income. The business is often their largest asset, the product of decades of hard work, and the keystone of their family's financial future. Yet, despite this importance, business owners frequently overlook critical planning considerations that could threaten both their company's continuity and their personal financial objectives.

Financial professionals are uniquely positioned to identify vulnerabilities and help clients coordinate with legal, tax, and insurance advisors. So, let's take a look!

ESTATE EQUALIZATION

Many people, if asked to describe how they want their children to be treated in their estate and legacy plans, will usually use the words "fairly" or "equally," but perhaps without full regard for how that may be best accomplished. And, as the saying goes, "fair" doesn't necessarily mean "equal," and "equal" doesn't necessarily mean "fair."

One of the more challenging estate and business succession planning questions arises when the next generation has unequal involvement in the family business. Consider a business owner with three adult children, only one of whom works in the company. The owner intends to leave the business to the participating child but also wants to provide an equal inheritance to the other two children. If the business represents a majority of the owner's net worth, achieving both objectives can be quite tricky. Dividing ownership *equally* may create conflicts between active and inactive heirs, while leaving the business entirely to the participating child ("*fairly*") could result in a substantially unequal distribution of wealth.

Life insurance provides an effective solution. By creating liquidity outside the business, a policy can allow the owner to transfer the company to the participating child while providing other heirs with assets of comparable value. Financial professionals should encourage clients to consider what constitutes a

"fair" inheritance, how the business is/will be valued, and whether sufficient nonbusiness assets exist to accomplish their objectives.

PROTECTING THE BUSINESS THROUGH ITS PEOPLE

Business owners can and often do make the effort to insure against operational risks, making sure their property, equipment, inventory, etc. (*i.e.* stuff) is covered. But what happens when the loss of a critical *person* threatens the company's financial stability?

A key person might be a founder, executive, salesperson, or employee whose expertise, relationships, or leadership materially contributes to the company's success. The death or disability of such an individual can result in lost revenue, disrupted operations, increased borrowing costs, and substantial expenses associated with recruiting and training a replacement.

Key person insurance is designed to help mitigate these financial consequences. Generally, the business owns the policy, pays the premiums, and would receive any death benefit to defray the consequences of losing an important member of the company.

Financial professionals should help business owners identify indispensable personnel and evaluate the potential financial impact of losing them. Moreover, insurance can be used as a retention tool for individuals integral to the business (known as "golden handcuffs"). Advisors may readily assist business owner clients in exploring coverage for the "stuff" of the business while unfortunately ignoring the other side of the coin: the *people* that make the business successful in the first place.

SUCCESS IN SUCCESSION

One hundred percent of business owners will exit their company, whether through retirement, disability, death, or a sale opportunity. Unfortunately, not every business owner has established a robust plan for that inevitable transition.

For businesses with multiple owners, a properly structured buy-sell agreement can make a world of difference by establishing the circumstances under which an ownership interest may or must be transferred, who can purchase it, and how its value will be determined. The fairly recent Supreme Court decision in *Connely v. U.S.* served as a wake-up call for business owners to know and follow their buy-sell agreements and potentially re-examine their structure for optimal estate tax planning.

An agreement alone, however, does not guarantee a successful transition. Funding is equally important, and life insurance is frequently used as a dependable source. By funding a buy-sell with life insurance, owners can establish liquidity to allow for the buyout of a departed owner without exhausting capital or relying on external financing.

Advisors should recognize the advantages of properly drafted and funded buy-sell agreements and also assist their business-owner clients in having the documents and funding reviewed periodically, as changes in ownership, business valuation, or company structure can render previously appropriate arrangements inadequate.

WHERE DO WE GO FROM HERE?

These crucial planning areas are often interconnected, and an arrangement or update intended to solve one problem can inadvertently create another if implemented without considering the owner's broader financial and estate planning objectives.

Financial and insurance professionals need not provide legal or tax advice to add substantial value. By asking informed questions, identifying potential gaps, and facilitating collaboration among the client's professional advisors, they can help their business owner clients protect what they have built and prepare for its future.

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