

Life Insurance Strategies for Individuals and Business Owners

Life insurance can be a valuable tool for you both individually and as a business owner to save taxes, recover from the loss of a key executive, and successfully exit your business. Here are a few ideas for using life insurance you might find beneficial.

IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

One of the best methods of keeping life insurance proceeds out of your estate and ensuring that your estate has the necessary liquidity to meet its obligations is to create an irrevocable life insurance trust (ILIT). As a source of funding, you can transfer an existing life insurance policy (or other assets) to the ILIT. Alternatively, the ILIT can purchase a new life insurance policy. At your death, the proceeds from the life insurance policy are paid to the ILIT, *not to your estate*. The ILIT effectively removes assets from your estate (and from your surviving spouse's estate) while at the same time making the insurance proceeds available to meet the needs of your surviving spouse, estate, and beneficiaries.

With an ILIT, you as grantor of the trust select the trustees who will manage the insurance proceeds and specify how such proceeds should be invested. In addition, you can determine when your beneficiaries will receive the policy proceeds. Assets in the trust, whether a life insurance policy or otherwise, are not subject to probate and can, in many cases, be protected from creditor claims. The trustee of the ILIT may (but cannot be required to) purchase assets from or loan money to your estate, if necessary, providing liquidity to pay debts and taxes.

KEY PERSON LIFE INSURANCE

When the continued success of your business enterprise depends on the abilities, talents, or services of a particular employee (key employee), it is appropriate for your company to insure that person.

Key person insurance should be owned by, and payable to your company, and the company should pay the premiums. The premium payments will not be deductible by the company for income tax purposes and will not be taxable to the employee as compensation (assuming the employee has no beneficial interest in the policy). In addition, your company will receive the insurance proceeds tax-free.

The amount of key person insurance needed is based on the value of the key employee's services, the increase in net income and goodwill attributable to the key employee, and the cost of recruiting and training a replacement. One approach is to pick some multiple of current salary as a proxy for his or her value (a common formula is 5 to 10 times the key employee's annual salary).

BUY/SELL AGREEMENTS

Buy/sell agreements help provide a ready market for selling an ownership interest in a closely held business. Typically, the agreement provides that an owner's interest in the business will be sold (or at least offered for sale) at a specified price to the business entity or the other owners when a specified event occurs. The events that will trigger the sale of the ownership interest are specified in the buy/sell agreement. Common triggering events include an owner's death, disability, or retirement.

Life insurance is often purchased to fund the sale of a business under a buy/sell agreement. In the right circumstances, using funds from an insurance policy can be the most efficient and economical way to fund the purchase of a business interest at the death of an owner. Life insurance that builds cash surrender value (whole, universal, or variable life) can also help fund a sale at the owner's retirement. The owners' ages and health should be considered when determining whether life insurance should be used to fund a buy/sell agreement. It might be cost-prohibitive to acquire life insurance for older owners or those who are in poor health.