Insured solutions for business owners

Wealth Management

Invest in the future of your business

As an entrepreneur, you spend your time, energy and money building a successful enterprise. You see a unique business opportunity, develop a creative idea for a product or service, and you work hard to realize your vision. You may also have employees who depend on you and your business for their financial security.

Indeed, your business is a valuable asset, regardless of its size or structure. And you want to make sure that you, the business and the families involved are adequately protected—and prepared—for the future, financially.

At RBC Wealth Management, we have access to the insurance solutions needed. Together with your attorney and tax advisor, your financial advisor will help you develop a strategy to help protect the future of your business.

What are the typical insurance considerations for various business structures?

Like people, who come in all sizes, shapes and walks of life, every business is unique, with a "fingerprint" and "personality" all its own. Businesses may share similar goals, depending on present and future needs, financial circumstances and life stages.

Depending on how your business is structured, you may want to explore ways insurance may help solve concerns you wish to address.

Sole proprietorships

You are an owner/operator of your business. You enjoy the flexibility and freedom to make all of your own decisions. You are also responsible for all liabilities your business may incur. As a result, you may be thinking about:

- Preserving your family's income in the event of your death or disability.
- Safeguarding your family and business against unexpected losses.
- Monetizing your business and succession planning when you want to retire.

Partnerships

You are part of a team who is in business together. You and your partners combine your individual efforts and talents to share in the risks and rewards of running your business. Because you depend on one another to be successful, you may be thinking about:

- Preventing financial disruptions if a partner dies or is disabled.
- Keeping revenues flowing if a key partner dies or is disabled.
- Determining how to equitably terminate or reorganize the partnership if a partner dies.
- Purchasing a deceased or disabled partner's business interest in order to continue.
- Working effectively with the family members or heirs of a deceased or disabled partner.

Closely held corporations

You and others have incorporated your business and invested capital to each own a share of its profits. So the continued success and growth of the business depends on the ongoing efforts and commitment of all owners. Which is why you may be thinking about:

- Protecting the value of your shares and finding a buyer if you need to sell your business interest.
- Determining which family members or heirs are qualified to manage the company if you die or are disabled.
- Helping them participate in corporate management if they have the ability and interest.
- Helping them negotiate with surviving shareholders on policies.
- Determining if you want a decedent's family or heirs as co-owners if another shareholder dies or is disabled.
- Determining how workload will be divided and profits split among them if another shareholder dies or is disabled.

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Limited Liability Companies (LLCs)

You are part of a team, like a partnership. And you have incorporated your business, like a corporation. However, you have structured your company a little bit differently for revenue sharing and tax purposes. So in addition to the same issues as a business owners participating in partnerships or closely held corporations, you may also be thinking about:

- Establishing a buyout price for estate tax purposes.
- Making sure the buyout price will be respected.
- Determining when an LLC needs to be liquidated if an owner becomes disabled or dies.

Regardless of how your business is structured, if you have employees, you may wish to explore the features and benefits of buy-sell agreements, key person insurance, executive bonus plans and deferred compensation arrangements.

Let's explore some of these concepts.

Buy-sell agreements — To help confirm equitable business owner transition

A buy-sell agreement is a legal contract an attorney can draft to help you establish the terms and conditions of a future sale or buy back of a departing owner's share of your business. Specifically, it can help you control:

- When owners can sell their interests
- Who can buy an owner's interest
- How much the transaction will cost

Establishing these terms and conditions allows you, your business and the other owners to protect yourselves from adverse consequences, such as disruption of operations, entity dissolution or business liquidation, that might result from the sudden death or incapacity of one of the owners. An important benefit of writing a buy-sell agreement is it can help you and the other owners minimize the possibility that your business could fall into the hands of outsiders if one of you dies or is disabled.

A buy-sell must clearly identify the potential buyers, any restrictions and limitations, and the conditions under which a sale will occur. Sale triggering events may include:

- Death
- Long-term disability
- Retirement
- Divorce
- Personal insolvency or bankruptcy
- Criminal conviction
- Loss of professional license
- Resignation or termination of employment

A buy-sell plan can be structured to address individual goals and tax considerations of both the business and the owners. Four basic structures are available for you to choose from.

1 An entity purchase buy-sell obligates the business to buy the interests of each departing or deceased owner.

2. A cross purchase buy-sell obligates each owner to buy a share of a departing or deceased owner's interest.

3. A unilateral or one-way buy-sell allows one owner to sell an interest, and is typically used when a sole proprietor is arranging to sell the business to a family member or key employee.

4. A wait-and-see buy-sell gives flexibility for either the business or the other owners to buy the business interest. Usually the business is given the first right to buy the interest and the remaining owners are given the second right.

   Should the business forgo its first right to purchase the interest—and no owners wish to exercise their right to purchase the interest—the business is obligated to buy the interest, just as with an entity purchase buy-sell.

Key person insurance — To help confirm business continuity

Businesses may depend on critical employees for their long-term profitability. Examples may include owners whose loss would jeopardize credit availability, top sales people or employees who innovate new products/services. Key person insurance is a life insurance policy purchased by an employer on the life of a critical employee to help protect the business from the financial loss resulting from that employee's death.

Should the funds be needed, key person policy proceeds can be used to hire and train a replacement. They can be utilized for loan repayment, to satisfy a completion bond on a project or generally to maintain credit. Having key person policies in place can help your creditors, employees and shareholders feel confident about your business' long-term stability and viability.

For key person life insurance, your business owns the policy, pays the premiums and is the beneficiary. For tax purposes, key person insurance is not considered a tax deductible business expense. Several methods are available to determine the amount of coverage purchased.

- Loss of business value
- Loss of excess earnings
- Cost to replace experience
- Cost to replace contributions
- Cost to replace lost sales profits
- Multiple of salary (This is the default amount many underwriters use when another method is not specified in your application.)

Executive bonus plans — To help attract/retain top talent

Also known as a Section 162 Bonus Plan, an executive bonus plan is an arrangement where you pay a bonus to an executive by paying the annual premium on a life insurance policy for the executive. The executive will be the owner of the policy and have the right to name the beneficiaries of the policy.

Pre-retirement, your employee enjoys cost-effective death benefit protection for his or her family. The only cost to him or her will be paying income tax on the amount of the bonus used to pay the premium. The life insurance policy cash value (owned by your employee) grows on a tax-deferred basis. At retirement, he or she may use the cash value in any way desired, including supplementing his or her income through policy withdrawals and loans. Though the policy is owned by the employee, the arrangement may contain restrictions as it relates to employee access to the policy.

As you can imagine, offering an executive bonus plan may enhance your overall compensation package, help recruit new employees and provide an incentive for participating employees to stay with your business. Plus, the amount of the bonus will be tax-deductible to your business as long as it meets reasonable compensation guidelines under Section 162 under the Internal Revenue Code.

Deferred compensation plans — To motivate and reward high-earning employees

Because qualified employer-sponsored retirement plans, traditional Individual Retirement Accounts and Roth IRAs are subject to contribution and income limits, many highly paid executives may have difficulty saving sufficiently for retirement. As an incentive to your top executives, you may want to consider offering a non-qualified deferred compensation plan to help them feel more confident about their ability to maintain their lifestyle during retirement.

To fund the plan, you and the employee enter into a contractual agreement where the employee defers a portion of his or her current income and bonuses into the non-qualified deferred compensation plan. As the employer, you may also contribute funds to the plan. Contributions may be based on a target retirement income goal or on an amount the employee feels he or she can afford to contribute.

If a non-qualified deferred compensation plan is informally funded with life insurance, the policy cash value grows tax deferred. Assets used to informally fund the plan remain assets of your business and are subject to the claims of the business's creditors. The retirement benefit payments are tax-deductible to your business when made to the employee at retirement. The employee is required to pay ordinary income tax on the payments upon receipt. Should a participating employee die prematurely, your business would also receive the policy death benefit free of income tax. The business has an obligation to the deceased employee beneficiaries to the extent of the employee's account balance.

Like qualified plans, non-qualified deferred compensation plans offer flexibility to you and your employees. A vesting schedule for your business's contributions can be included to encourage employees to remain with your company for specified period of time. Pre-retirement disability or death benefit payments may be included. And plan payments, at the employee's retirement or other specified ascertainable date, can be paid out periodically or as a lump sum. You can also design the plan to recover the costs associated with offering it.

Make the right moves

Your RBC Wealth Management financial advisor can work closely with you, your attorney and your tax advisor to help you choose the insurance solutions that are right for your business. Contact your financial advisor to get started on a strategy to invest in the future of your business.

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