A STRATEGY SPOTLIGHT

“IBETE” I Know What’s on Your Mind

Five Questions That Business Owners Must Ask Themselves

The acronym “IBETE” (pronounced I bet), represents questions relating to income, business loans, employees, transfers, and estate planning. Considering these topics is essential for business owners. Your business is probably your most important and valuable asset. You depend on it for steady income. You also predict that one day you will be able to cash out and retire. The key, however, is to plan for that goal as early as possible. And, by considering the IBETE questions on the following pages, you will be well on your way.

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Income

How would you maintain your standard of living for yourself and your family if you died, became disabled, or retired?

Your business is your livelihood. You rely on it to generate income and provide the lifestyle you and your family have become accustomed to. Consider that a 45-year-old female business owner who is paying herself $100,000 per year would need to withdraw $2 million from the business over the next 20 years in order to maintain her lifestyle. Could your business afford to make those payments if you died, were hurt, or became ill and could not work for an extended period of time? If not, consider using life insurance together with disability income insurance to help replace a portion of your salary in the event that you are too sick to work, become disabled, or die.

Additionally, business overhead expense insurance is designed to reimburse the business owner for expenses in the event that she or he is disabled and cannot pay them because of a decrease in income due to disability. This protection can help ensure the business continues operating.

Business Loans

Many business owners have to personally guarantee their business loans. What happens to these loans if you die, become disabled, or retire?

You may think that as an owner of a business entity, you are protected by a corporate shell from corporate debt. However, many things changed in the banking world after 2008. Many banks and lenders now require the owner of the business to personally guarantee loans made to the business entity. Check your loan documents (including your annual lines of credit) and ask who would be responsible for those loans if you died, became disabled, or retired.

Employees

Many closely held businesses depend on one or two key employees. Ask yourself this — who would you take with you if you closed your business and started a new one? What would happen to your business if your key employee died, became disabled, or just did not show up at work?

You value your key employees and their daily contributions. However, have you thought about the impact that losing one of them would have on your business? Think about the value they bring — whether it's their creative genius, sales acumen, or leadership qualities — and what those characteristics are worth to the business. Having the foresight to protect your business against the loss of an essential employee, perhaps a company's most valuable asset, can be vital for the long-term success of your business. To properly protect the business from the loss of an integral employee, which will likely result in lost sales, productivity, or even some good customers, the company can purchase life and disability income insurance on that key person. This insurance will pay a valuable death benefit to the business, which can help replace the lost revenue while a replacement for the key employee is found.

Transfer

What would you like to do with your business? If you do nothing, your estate planning documents (or state laws of intestacy) will decide the next owner. If you would like to sell the business, do you have a written and funded plan in place? Even if you sell the business or just walk away from it, how would your family be impacted by the loss of income?

Answering these questions will help you explore your succession plans — your hopes and dreams for your company after you leave it, either as planned or due to a disability or death. Surprisingly, a fairly large number of businesses end up in liquidation or are forced to sell their assets to pay off their debts. Liquidation normally does not allow you to maximize the sale of your assets. In fact, the seller may only realize 50 or 60% of what the sale would realize if the assets had been sold under "normal" conditions. However, if a successor is properly identified in advance of retirement or an unforeseen event, the successor can help to make sure the transfer of the business will occur without any issues. This underscores the importance of having a written plan in place called a buy-sell agreement, which requires one party to sell and another party to buy the ownership interest in a business in the event of certain triggering events. To provide cash for the transition, the agreement often can be funded by life insurance and disability income insurance to allow ownership and control to be maintained.

Estate Planning

Should you be concerned about federal or state gift or estate taxes? Would you like to give some or all of the business to family? How will the gifts impact your estate plan?

Under current federal estate tax law, each U.S. citizen or resident may pass a certain amount of property during life ("a gift") or at death ("an inheritance") before incurring the 40% federal tax. For calendar year 2021 that amount is $11,700,000 for a single person and $23,400,000 for a married couple. It should be noted that these exemption amounts are scheduled to revert back to $5,000,000 (inflation adjusted) on January 1, 2026.

Each person can also make gifts of up to $15,000 (2021) per year to an unlimited number of people ("annual exclusion gifts"). If you are interested in transferring some or all of your business to family and loved ones, it may be possible to leverage these amounts and perhaps actually shift even more property to your family without incurring a federal gift or estate tax. Certain states impose separate gift and estate taxes, so any gift strategy should consider and plan for the impact of those taxes.

The business interest is often the single largest asset of a closely held business owner's estate. Often, it is used to provide the majority of current income and support to the family and will be looked to as a source of income and wealth at retirement. Understanding and ultimately realizing the value of the business and developing and implementing a succession plan for the entity, whether because of death, disability, or retirement, is critical to the continued well-being of the family.

Asking the IBETE questions is one way to start addressing the issues. Since each situation is different and laws differ state to state, work with your personal tax and legal advisor to discuss taking advantage of these strategies.

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The decision to purchase life insurance should be based on long-term financial goals and the need for a death benefit. Life insurance is not an appropriate vehicle for short-term savings or short-term investment strategies. While the policy allows for loans, you should know that there may be little to no cash value available for loans in the policy's early years.

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