M Financial Group™

June 2017

M Intelligence

Enhancing understanding of sophisticated planning strategies and their applications.

Business Protection and Benefit Planning Strategies

Life insurance is a powerful and flexible financial instrument with many useful applications for companies of all sizes. For business owners, it can help facilitate business continuity, protecting the company against the loss of a key person, providing liquidity to fund a succession plan, and ensuring the company can thrive well into the future. Used as a benefit, life insurance can help employers recruit, retain, and reward employees and executives.

Key Person Life Insurance

Key person life insurance is coverage taken out by an organization to protect the business against financial loss in the event of a key person's death. The key person may be an owner, an executive, or anyone else whose death could create a financial hardship for the company. A key person insurance policy is owned and paid for by the company, insures the key person, and names the company as the beneficiary.

Buy-Sell Agreements

A buy-sell agreement ensures that surviving owners of a business have the right to purchase the interest of any owner when that owner dies. It also ensures that the deceased's beneficiaries are fairly compensated for a business interest they inherit. Life insurance is often used in conjunction with a buy-sell agreement, as it provides liquidity to fund the success plan exactly when it is needed–upon the death of an owner.

Group Life Insurance

Group life insurance is used as a benefit for the employees of a company. In this type of plan, each eligible employee is covered under a master contract at premium rates that are based on the age and gender of the insured. Group life insurance Plans may be completely employer paid or may have a contributory element where each insured picks up some or all of the premium. Group life insurance usually terminates when the employee leaves the company. However, some plans allow employees to convert coverage to an individual life insurance policy upon termination.

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Section 162 Plan

Often called "executive bonus plans," section 162 plans are a simple way to reward top executives. Under this type of plan, an executive purchases a permanent life insurance policy on his or her life. The employer bonuses the employee the premium, which is usually taxable income to the employee and tax-deductible to the employer. The employee controls the policy, including the death benefit and the cash value, which accumulates tax-free until it is withdrawn.

In some cases, a "restrictive endorsement" is used, which limits the employee's access to the policy cash value until a qualifying event occurs, such as the attainment of a certain age or years of service, a disability, or normal retirement. This serves as a type of "golden handcuffs," allowing employers a way to retain top employees.

Deferred Compensation Plan

In a deferred compensation plan, an executive defers a portion of his or her present compensation until retirement. These plans may discriminate as to which employees are eligible to participate, and are often limited to only a small group of top executives.

Under a properly designed plan, no income taxes are incurred by the participant until the money is received. However, an employer may not deduct any amounts paid to plan participants until funds are actually distributed. Often, life insurance policies are used as an informal vehicle for holding and growing the deferred funds.

Supplemental Executive Retirement Plan

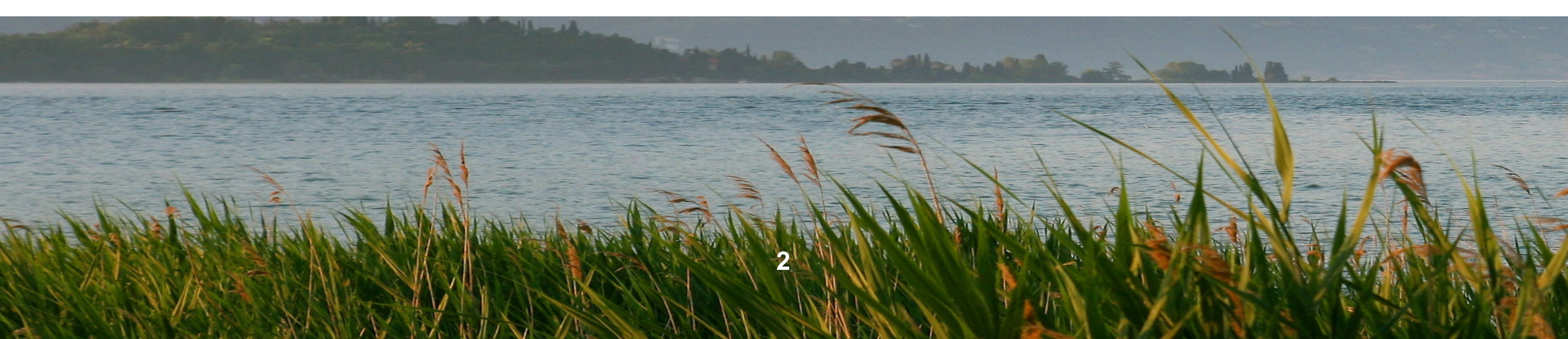
In a Supplemental Executive Retirement Plan (SERP), the employer provides funding for a defined benefit or defined contribution plan for a select group of employees. A SERP provides for a series of payments to be made to the executive at retirement. The plans also often promise to pay the executive's spouse a benefit if the executive dies prior to retiring. SERP benefits are often informally funded by life insurance.

Split Dollar Life Insurance

Split dollar life insurance involves the purchase of life insurance where the ownership of the policy cash value and death benefit is divided. The executive owns a portion of each, and the employer, which typically pays all or most of the premium, owns the remainder. This type of insurance plan is often used when a company wishes to provide lifetime protection for an employee while retaining the ability to obtain cost recovery for its policy contributions.

Considerations

- Each organizational structure (C-Corporation, S-Corporation, LLC, etc.) is subject to a unique set of rules affecting life insurance planning. Compliance with IRS rules and regulations, state and local laws, and in some cases the Employee Retirement Income Security Act of 1974 (ERISA) is required.
- Not every plan type described above is appropriate for each organizational structure.
- Organizations subject to the Alternative Minimum Tax may have additional considerations for plans where death benefits would be paid to the organization.



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- Internal Revenue Code Section 101(j) applies to all employer owned life insurance contracts that are issued or materially modified after August 17, 2006. Section 101(j) requires employees to be given written notice before the issuance of a life insurance contract and provide written consent to such life insurance. In addition, the employer must annually report life insurance arrangements to the IRS by filing form 8925 with the employer's tax return.
- In general, benefits provided to the employees of an organization will result in taxable income to the employee. Certain exceptions apply.
- Professional tax and legal advisors should be consulted before entering into any insurance arrangement.

Circular 230 Compliance: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this bulletin is not intended or written to be used, and cannot be used, for the purpose of (a) avoiding penalties under the Internal Revenue Code, or (b) promoting, marketing, or recommending to another party any transaction or matter addressed herein. All programs and techniques presented are subject to applicable federal and state laws.

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