

**OHIO EMPLOYEE OWNERSHIP CENTER**  
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**The Uses of Life Insurance in Your Succession Plan**

By

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## The Practical Aspects of Planning; The 3 What's

- The **first What** - What does the senior generation *require* from the business going forward.
- The **second What** - What can the business *afford*.
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- The **third What** - What is the business *worth* or what is *fair*.

# Insure the Three What's

- Insurance can be used to provide funding for the senior generation (CSV)
- First to die policy can provide assurance survivor is secure and not dependent upon business survival or success
- Second to die policy can provide necessary liquidity to avoid use of business resources to pay taxes

# Insure the Three What's

- Life insurance on the successors assures the senior generation gets paid if a successor suffers an untimely death
- Key person insurance on successors or managers assures continuity in the enterprise and addresses lender's concerns

# Insure the Three What's

- Insurance is a tax advantaged method of providing fairness/equalization for family members not employed in enterprise
- Premiums are not deductible but proceeds are free from income and estate tax
- Reasonable way for successors employed in business to effectively buy out their siblings

# Insure the Three What's

- Insurance provides economic benefit to the non-employed family members and removes their dependence upon the continued success of the enterprise

# Nuts & bolts of assembling a Succession Plan

## The 4 d's

- **Death**. What happens when an owner dies:
- **Disability**. If an owner is permanently disabled should it affect their ownership interest?

## The Nuts & bolts of assembling a Succession Plan

### The 4 d's

- **Departure**. What happens when an owner leaves the enterprise?
- **Discord**. What happens if the owners cannot resolve disagreements over the strategic decisions affecting the business?



# Insuring the Four D's

- Insure each owner to provide economic value to their family independent of the business
- Insurance allows the successors/survivors to operate the business without financial obligation to the deceased owner's family
- Insurance allows the survivors to acquire the ownership at a discount (the premium)

# Insuring the Four D's

- Permanent insurance provides access to tax free cash to pay disability or lifetime benefits to a disabled owner
- Insurance allows the entity to realize cost recovery for lifetime buyouts on a tax free basis

# Insuring the Four D's

- Permanent insurance provides access to tax free cash for lifetime buyouts
- Insurance allows cost recovery on a tax free basis for departures of owners

# Nuts & bolts of assembling a Succession Plan

## The 4 d's

- The ultimate exit strategy for owners who can not resolve their differences needs to be incorporated into an agreement to prevent the entity's demise.
- **The Put**. Seller tenders his/her shares with the entity or other owners required to buy.
- **The Call**. The buyer forces the other owner to sell

# Nuts & bolts of assembling a Succession Plan

## The 4 d's

- Push-pull mechanisms
- a deterrent to inappropriate puts-calls.
  - one of the owners to set price and terms  
(the more detailed the more effective)
  - the other owner selects whether they will  
buy or sell at the stated price under the  
offered terms.

# Insurance Vehicles

- Irrevocable Life Insurance Trust
- Wealth Replacement Trust
- Cross Purchase Agreements
- Redemption Agreements
- Corporate owned insurance (Section 6166 and Section 303 of the Internal Revenue Code of 1986 as amended)

# Insurance Vehicles

- Bonus Plans (insurance owned by Employee)
- Golden handcuffs (insurance owned by entity)
- Partnership/LLC Insurance

# Types of Insurance

- Permanent
- Term
- Combination



# Types of Insurance

- Permanent
  - Variable
  - Whole life
  - Universal
  - Variable Universal
  - Single Premium
  - Section 1035 Exchanges

# Types of Insurance

- Term
  - Level Term
  - Increasing/decreasing term
  - Renewal Term
  - Convertible Term
  - Group Term
  - Insurability and long term cost

## Techniques used in Succession Planning

- Gifts
- Installment Sale
- Buy-Sell Agreements
  - Close Corporation Agreement
  - Operating Agreement
  - Partnership Agreement

# Techniques used in Succession Planning

- Installment sale to intentionally income tax defective trust “IDIT” add insurance element
- Short term grantor annuity Trust “zeroed out GRAT” [under attack by Obama Administration]

# Techniques used in Succession Planning

- Long term GRAT
- Family limited partnership and Limited liability company
- Private annuity (insurance for surviving spouse)