



## A Better Business Succession Plan Lifetime Buyout Using Cash Value Life Insurance

How many times have you asked your clients about their business succession plan and discovered they have a buy-sell agreement in place along with a term life insurance policy? Many clients may believe they have solved their business succession plan with this approach, but that may not always be the case.

At 70 years old, the majority of men are expected to live another 10 years, and a quarter are expected to live to see 90. Interestingly, women are generally expected to live longer lives than similarly aged men as they grow older.<sup>1</sup> That means the great majority of adult men and women will live well into their retirement years. For business owners, a buy-sell strategy funded by term life insurance only addresses one potential outcome: death. This approach fails to meet the needs of most entrepreneurs and puts their business, other owners, and family members in a potentially difficult situation when the business owner retires or becomes disabled.



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Pacific Life's Advanced Designs Unit consists a team of highly respected professionals who specialize in advanced life insurance planning.

### Failure to Adequately Plan

One situation I encountered recently was a life insurance producer with a business owner client getting close to retirement. The client co-owned the business with a younger individual. In addition, a previous co-owner had recently retired and was receiving buyout installment payments from the business. They had buy-sell agreements in place along with term life insurance policies, but they had done nothing further in terms of succession planning.

You can see the dilemma for the client and his business. The enterprise would soon have to support two retired owners and bear the burden of two installment buyout payments. Unfortunately, there was no easy solution for this client. There was insufficient time to put anything meaningful in place that would help the client with his buyout at retirement. The remaining owner would have to use more income from the business and potentially personal assets to buy out the retiring owner.

***Bringing You Planning Ideas that Incorporate Life Insurance***

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<sup>1</sup>Source: "The odds of dying in the US by age, gender and more", Finder.com, (found at <https://www.finder.com/life-insurance/odds-of-dying>, as of September 11, 2023).



## A Comprehensive Strategy

A more comprehensive strategy may be to plan for both a buyout at the death of the business owner client and a lifetime buyout for an exit at retirement, disability, etc. Using cash value life insurance may address both the premature death of a business owner and the desire or need for a lifetime buyout of a business owner.

For these business owner clients, they are already incurring or ready to incur the mortality cost of life insurance with the term life insurance. Using cash value life insurance, instead, gives them the same death benefit protection that term policies offer. While the cost of cash value life insurance is usually greater than that of term insurance, it may allow the business or business owner to establish a policy cash value which may be accessible in the future when the buyout occurs. This strategy of creating a sinking fund during the insured's lifetime reduces the future reliance on profits from the business or personal assets to buyout retiring owners.

## Why Cash Value Life Insurance?

Why use cash value life insurance as the vehicle for funding for the future buyout? If the business is willing to put away money today for the buyout, why not use stocks, bond, mutual funds, or other assets? Because cash value life insurance offers additional benefits, such as:

- **Death benefit protection** in the event that the business owner client dies prior to retirement.
- **Tax-deferred growth** of the policy's cash value.
- **Tax-free access** to the policy's cash value via withdrawals and loans.<sup>2</sup>

Using cash value life insurance as a funding vehicle may give business owners a more comprehensive approach to business succession planning, which may allow owners to prepare for a future retirement and protect their family in the event of death.

<sup>2</sup>For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death (any outstanding policy debt at time of lapse or surrender that exceeds the tax basis will be subject to tax); (3) withdrawals taken during the first 15 policy years do not cause, occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC §§ 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.

For more information about life insurance,  
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