DBS

BUSINESS USES OF LIFE INSURANCE

DIVERSIFIED BROKERAGE SERVICES, INC.

There are six key ways in which life insurance may benefit your business.

1 Business Transfer

Businesses or business owners can execute a buy-sell agreement and fund it with life insurance. A buy-sell agreement is an arrangement for a business to continue in the event of the owner's death, disability, retirement or early withdrawal from the business. Life insurance, through the death benefit or cash values (if a permanent policy is used), can help provide the funds for the surviving business or new owner(s) to purchase the business interest.

2 Key Employee Protection

The loss of a key employee can severely affect the financial health of a business in several ways: lost sales, costs of recruiting and training a replacement, costs to continue the salary to the employee or the family, or loss of credit. Life insurance can provide the business with funds to temporarily replace lost profits as a result of a key employee's death, strengthen the business's working capital, and provide funds that may be used to recruit and train a suitable replacement.

3 Non-Qualified Deferred Compensation (NQDQ) Plans

NQDC plans funded with life insurance can help attract and retain key employees. Such plans are contracts between employers and key employees to pay future compensation for work performed now. Most NQDC plans provide for a stream of payments to be made to the employee following retirement. The payments typically come from the cash value of a permanent (rather than term) life insurance policy. The employee is not taxed on the money until it is received.

4 Executive Bonus Plans

Another way to provide an extra benefit to key employees is through an executive bonus plan. With this plan, the employer gives a bonus to a key employee who then pays taxes on the money and uses the remainder to purchase a life insurance policy. The employee has all ownership rights in the policy, such as access to the cash value and the power to designate beneficiaries, while the employer receives a tax deduction for the bonus.

5 Supplemental Executive Retirement Plans (SERPs)

SERPs provide key employees with supplemental retirement income generated by the cash value of a life insurance policy. Qualified defined contribution plans are limited to considering only the first $230,000 of compensation when arranging retirement benefits for highly compensated employees ($245,000 in 2009). SERPs layer in on top of such defined contribution plans, giving key employees a more robust total retirement plan package.

6 Debt Coverage

Life insurance proceeds can provide a business with funds to help pay off business debts in the event of the owner's premature death. A life insurance policy is taken out on the life of the owner when the debt is first incurred.

Note: Partial withdrawals and surrenders from life insurance policies are generally taxed as ordinary income to the extent the withdrawal exceeds the investment in the contract, which is also called the "basis." In some situations, partial withdrawals during the first 15 policy years may result in taxable income prior to recovery of the investment in the contract. Loans are generally not taxable if taken from a life insurance policy that is not a modified endowment contract. However, when cash values are used to repay a loan, the transaction is treated like a withdrawal and taxed accordingly. If a policy is a modified endowment contract, loans are also taxable, and loans, withdrawals and surrenders are treated first as distributions of the policy gain subject to ordinary income taxation, and may be subject to an additional 10% federal tax penalty if made prior to age 59½. Loans, if not repaid, and withdrawals reduce the contract's death benefit and cash value.

Internal Revenue Code Section 101(j) limits the death proceeds an employer can exclude from income when the insured is not a director, a highly- compensated employee or a highly-compensated individual at the time of policy issue, or when the death benefit is not used to purchase the insured's ownership interest in the business. The Code also imposes specific requirements that the employer provide advance written notice to the individual about the insurance, secure his written consent and submit annual reports to the IRS.

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