Business Life Insurance

Here is the First in a Series of Exclusive Articles Showing Contractors What They Should Know About Business Insurance

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Business life insurance is life insurance used to protect a business, or the family of a businessman, from the financial loss which results from the death of someone associated with the business. Many billions of dollars worth of this protection is now in force, giving assurance of business continuity to the firms and full value of the business equity to the family of the deceased.

There is no basic difference between business life insurance and the life insurance used for personal and family needs. But the protection set up by business firms does involve many more complex details to meet legal, financial, tax and technical problems. It is life insurance custom-tailored to the individual business and probably no two plans are precisely alike in all details.

There are numerous specific purposes for which business life insurance is written. Chief among these are:

1. Key-man protection to reimburse for loss or provide replacement in the event of the death of a key employee.
2. Partnership insurance, to retire a partner’s interest at death.
3. Corporation insurance, to retire a shareholder’s interest at death.
4. Proprietorship insurance, to provide for maintenance of a business upon the death of a sole proprietor.
5. Insurance to aid a firm’s credit status, covering the owner or key man during the period of a loan or the duration of a mortgage on property held.
6. Where the estate of a business man consists almost entirely of his interest in a business, insurance on his life, payable to his family on his death, to provide them with ready cash and to aid in liquidating his interest in the business.

Pension plans for employees, group life insurance, disability income insurance, hospitalization, surgical and medical insurance and major medical insurance are other types of personal insurance which are utilized by business concerns to help stabilize their activities and increase operating efficiency.

First Steps

The small construction business contemplating the establishment of a business life insurance plan faces technical problems that call for advice. The usual procedure is to consult four experts who can make certain that every angle of the firm’s interests is being safeguarded.

The four mean are: the firm’s attorney, its accountant, the trust officer of its bank, and its life insurance agent. The agent gives the technical advice concerning the arrangement of policies, while the others provide the essential information on which the plan is based. They also double check it when completed and assume responsibility for carrying out the legal and banking details.

Many life insurance agents who specialize in business life insurance are familiar with the whole range of problems. However, they prefer to have their client’s lawyer, banker and accountant drawn in for consultation.

The owner-manager, devoting his energies to making the business a success, is not usually in a position to analyze his insurance needs or prescribe the correct policies or policy arrangements to meet those needs. Such a prescription calls for highly specialized knowledge and technical advice.

Tax Factors

Tax factors, both income and estate, are involved in many business life insurance arrangements. These should be taken into consideration, so that the plan set up will not involve unnecessary additional taxes.

On the other hand, too much
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weight should not be given to the tax angles because they are constantly changing, and a plan set up today on the basis of a certain tax advantage may prove to be disadvantageous next year, if a new revenue bill is enacted or a new interpretation of existing law is made. This, too, is a matter that should be left in the hands of the experts.

Reserve for Emergencies

Most business life insurance plans utilize life insurance which has cash values. These cash values, growing over the years, provide the firm with a valuable reserve for emergencies, in the event of any sharp dislocation in business conditions. When necessary, the policy cash values can be used as the basis for loans. Where, for one reason or another, this type of policy is not possible, forms of term insurance may be used.

Key-Man Insurance

Almost every business has one or more men upon whom it depends heavily for its major success. Frequently it is the owner or manager. It might be the financial man, upon whose shoulders rests the responsibility of the firm’s credit, and for arranging new financing or for temporary credit needs. It might be the sales manager—or, in the case of a retail shop, a leading salesman or buyer. It might be a chemist, engineer, or scientist, whose technical efforts are vital to the firm’s success. It might be any employee whose death would cost the business something.

Key-man insurance is indicated for anyone whose death would cripple the business, or at least cause a setback until a replacement is secured. Such insurance provides insurance benefits at the death of this vital employee, so that the firm will have resources with which to employ and train a successor in the competitive market and to cushion the loss of profits in the meantime.

Partnership Insurance

In the absence of legal safeguards to avoid dissolution, a partnership automatically dissolves at the death or shortly after the death of any one of its partners. This results in cessation of normal partnership activities and the surviving partners become what is known as “liquidating trustees.”

They cannot do any new business but must confine themselves to winding up the affairs of the partnership. If they continue the business, they may become personally liable for any losses incurred should the assets not cover such losses.

There are several ways to avoid these difficulties, one of which is an adequately financed buy-and-sell agreement providing for the purchase at a prearranged valuation of the deceased partner’s interest. An attorney will draw up the necessary papers carrying out the wishes of the partners.

If a buy-and-sell agreement is decided upon the next step is to fund the arrangement, which can be done effectively through business insurance. It enables the surviving partners to reorganize at once and continue in business. It liquidates the interest of the deceased partner without loss. It enables the beneficiaries of the deceased partner to secure full, fair value for his interest in the firm, at once and with a minimum of trouble.
And it lends support to the credit standing of the firm.

**Corporation Insurance**

A corporation is not as directly and immediately affected by the death of a shareholder as is the partnership by the death of a partner, but unfortunate consequences are a distinct hazard. Unlike the partnership, the corporation is not terminated at the death of an owner, but with the transfer of the deceased stockholder’s shares, new stockholders (new to management and possibly an unknown element) may come into the picture. The death of a principal stockholder may deal a severe blow to the firm’s credit.

There are several ways to handle the problem. One way is an adequately financed stock sale and purchase agreement, drawn up by the firm’s attorney. This may be funded by insurance. An adequate corporation insurance program on the lives of its principal shareholders, provides retirement of their interest at once and reduces the shock of changes in ownership.

This is of special concern to the small corporation with a few shareholders whose interests keep them close to the management of the business. Frequently, ownership and management are one and the same. The great bulk of the country’s corporations are in this category. Large numbers of them are small, closely held businesses which adopted the corporate form primarily for its legal, tax, and continuity advantages.

By so doing, however, these owners have not escaped the death hazards which affect any business organization. Life insurance can provide the corporation with funds to purchase the interest of a stockholder at his death.
Individual Proprietorship Insurance

Life insurance protection for the sole proprietor, to provide his dependents or heirs with cash representing the sound valuation of the business at his death and to assure continuity of the business, is as yet an undeveloped and widely neglected area of protection. Probably this is true because the need is regarded as in the province of personal life insurance.

Even in the sole proprietorships, there are special considerations that should be recognized when writing the business policy. They include:

1. Adequate and specific provisions must be made to meet the conditions of a will or trust agreement concerning sale or liquidation of the business where such is desired.
2. Selection of the beneficiary must be made according to the particular situation.
3. The question of who is to pay the premiums should be determined in relation to the particular plan. There is no set pattern; each case has to be determined on its own merits. One plan may call for sale of the business to specified employees, with the purchase money provided by the insurance. Another may provide that the business be run by the executor or the heirs. In still another, a trust company may be named as beneficiary and management control may be established.

The specific plan is important, however. Many a small business has floundered upon the death of the sole owner merely because he did not take the proper steps while alive to assure its continuance. Numerically, businesses of the individual proprietor type predominate, comprising approximately 70 percent of all units engaged in manufacturing, wholesale, retail, and service trades.

The sole proprietor who is interested in selling his business to his employees should consult with an attorney and a life insurance underwriter about the advantages of combining a pension or profit-sharing plan with a purchase agreement, funded by life insurance on the life of the business owner.

Periodic Checkup

Once established, the business life insurance plan should receive periodically a careful checkup by experts. It is important that the details of the plan be kept up-to-date at all times. Financial conditions change, tax laws vary in effect, valuations of the interests of the owners are never constant-to mention but a few of the changing conditions that can affect the plan.

Revaluations should be made whenever necessary in connection with buy-and-sell agreements and partnership and corporation policies. Every new revenue act suggests need for a special checkup to make certain the tax angles are still adequately covered. At least once each year, the plan should go through this careful screening by the life insurance agent.