Who Needs Life Insurance?

Who needs it? Firms that need quick cash to keep operating when a key executive dies.

Seventy percent of the nation's retail, manufacturing, wholesale and service businesses are owned and managed by one person.

Most state laws provide that, upon the death of a sole proprietor, his business becomes a part of his estate. The business is administered by his executor and passed along to the heirs as quickly as possible, unless otherwise provided.

Heirs to a one-man business can suffer severe loss unless specific plans are made beforehand to assure continuation of the business.

When a sole proprietor dies, the business can be left to heirs, sold to employees, sold to outsiders, continued by executors or trustees, or liquidated. However, each of these procedures, unless set up under a carefully drawn plan, can raise problems.

If the business is passed to the owner's heirs, liquidation might be forced by the cash needs or demands of certain heirs-and a forced sale could result in severe loss. A son or other heir might not be qualified to run the business. The heir might still be a minor, might have friction with other heirs or with employees, or might be handicapped by lack of working capital or credit.

If the business is transferred to employees, or outsiders, there might be controversy over valuation or the availability of funds to carry out the transfer. The owner should consult with an attorney and life insurance underwriter about the possibility of combining a pension or profit-sharing plan with a purchase agreement. Such a plan can be funded by life insurance on the life of the business owner.

If an executor runs the business, he might hire an unsuitable manager. Among other things, this manager would know the work was temporary.

Even where there is a will, delays caused by administration could cause serious losses. Any change could disturb customer good will and employee morale, or could create credit difficulties.

Need for Funds

Whatever disposition is made of the business, funds will be needed. Debts, taxes and administrative costs must be met, family income maintained.

If family are continuing the business, funds may be needed to hire a manager. Also, working capital will be needed, at least for a period of readjustment.

If employees take over, funds for their purchase of the business must be made available, at least in part. Even if the business is sold outright, working capital is needed for the transition period and for discounting of assets.

Most of these funds are needed more quickly than can be provided by the sale of the business. Taxes are urgent and debts even more urgent, and must be promptly paid to maintain the business.

In a construction business, there is likely to be an immediate need for working capital. A highly specialized contractor might find it so difficult to find a buyer, that substantial funds would be needed to tide the business over while seeking a successor. Other construction businesses, built around some unique contribution or specialty of the proprietor, could find no buyer whatsoever and seemingly vanish overnight.

To meet these problems, proprietors must set up a plan for taking care of the business and the heirs at death. This plan should include:

- A will covering disposition of his business.
- A purchase and sale agreement, or carefully drawn plan for disposal or continuation of the business.
- An estimate of the funds required to carry out the details of the plan.

Consultation between the proprietor's insurance agent, accountants, trust officer, and attorney, is advisable. These experts can determine what is needed, and draw up a plan to meet the legal and financial requirements.

Details of such plans do not follow any set pattern. For example, business life insurance for a sole proprietorship —even more than for any other type of business—must be tailored to the particular case.

What the plan will involve, what kind of insurance is suitable, and how it will be set up, depends on such factors as: type of business; time urgency; disposition of the business; funds available; and probable needs in the period following death of the owner.

To assure the funds necessary to continue a business after the owners death, business life insurance for sole proprietorships is now widely in use. A suitable business insurance program should:

- Assure immediate funds to meet taxes, debts and administrative expenses.
- Provide income for the heirs.
- Equitably distribute the property value to the heirs.
- Enable the trustee to dispose of the business to best advantage, if the family is not taking it over.
- Put the family on sound financial footing, if it is assuming direction of the business.
- Stabilize the credit of the business.
- Maintain good employee relations by eliminating uncertainties and hazards.

Sole proprietorship life insurance is so closely linked with the owner's personal finances, the policy should be checked at least once a year. A business continuation plan, left unchecked, might prove not only inadequate, but actually handicap affairs at the proprietor's death.

Corporation Life Insurance

In the case of a corporation, life insurance is useful to protect against the loss of key employees or executives, or even provide funds for their replacement.

The death of a stockholder of a closely-held corporation may cause

Where there's a will, there's a way. A carefully drawn will can provide the funds needed to keep a business going after the owner dies—whether the firm is a sole proprietorship, partnership, or closely-held corporation.

serious repercussions in the business. Unless otherwise provided, the deceased stockholder's stock becomes a part of his estate, allowing his executor to vote the stock. If it is a controlling interest, the executor could even name a new board of directors and take over full control.

Should a principal stockholder die, therefore, many questions are raised automatically:

- Will management deteriorate if the heirs stay in?
- Will the heirs have the ready cash needed to meet death costs?
- Can money be found by the surviving stockholders to buy out the heirs?
- Will adequate income be provided the heirs if they retain the stock?
- What valuation is fair and equitable?
- Can a buyer be found for the stock?
- Will the firm's credit stand up under such a strain?
- How long will the whole matter be held in controversy?
- Will the firm's sales hold up?
- Will the employees become restive?

All these questions can be answered through a stock sale and purchase agreement, with life insurance to guarantee funds for carrying it out. Such agreements determine what will be done upon the death of a stockholder, and make funds immediately available for accomplishing the plan's objectives.

This applies whether the new owner of the stock is to be the surviving stockholder, any of the heirs, the corporation, the employees, or even outsiders. Being agreed upon by all stockholders in advance and periodically checked for adequacy of the valuation basis, the plan leaves all parties satisified and equitably treated. Stock is disposed at a price already stipulated.

Life insurance can provide funds to purchase the interest of a deceased stockholder at a minimum tax cost. When a decendent's stock in a closely-held corporation represents 35 percent of the gross value of his estate, the corporation may redeem enough of his stock to cover estate and inheritance taxes without imposition of ordinary income taxes.

The benefits of a stock sale and purchase plan are many. Continuity of management is guaranteed since no outsiders can come into the business unless agreed upon in advance. The cash needed to carry out the stock purchase is automatically provided on a basis previously agreed to as fair. Widows or heirs are not burdened by business responsibilities and having a guaranteed buyer and a guaranteed price protects them against shrinkage of stock values.

Not only is the firm's credit position saved, but is actually enhanced by the plan. Moreover, the morale of employees is assured for the period of adjustment.

Details of the plan should be individually tailored by the firm's life insurance agent, accountant, attorney, and banker. Specific problems of the particular business must be covered, but there are certain issues which should be clearly addressed in every such plan:

- Data about the parties involved in the agreement.
- A clause binding executors and heirs, as well as the stockholder, to the plan's provisions.
- Duration of the agreement.
- Purposes of the agreement.
- Description of the number and kinds of shares owned.
- The kinds, amounts, and arrangements of the life insurance set up under the plan, including who will apply for the life insurance, who will pay the premiums, to whom the benefits will be paid.
- Provision for any lack or surplus of funds available.
- Appointment of a trustee.
- Terms of transfer at death.
- Provision to permit sale of stock if owner may wish to sell prior to death.
- Proportion of deceased's stock each shall receive.
- Valuation of stock and provision for periodic revaluation.

Under stock sale and purchase agreements, life insurance premiums involved are not tax-deductible as an expense in determining income tax. However, neither are the benefits taxable under Federal income tax or estate tax laws.

Key-man life insurance is another important consideration, and provides funds with which to hire and train the needed successor. Such policies also help meet any financial loss resulting from the key employee's death.

Once the corporation's stock sale and purchase plan is set up, it should be revalued semiannually. For key-man insurance, at least annual checking is desirable to make certain all key figures are covered and their economic value to the business adequately protected.

With a business subject to constant change, and the relationship to the business of the insured persons frequently changing, policies must be kept up-to-date.