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 substan-
tial 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 agree-
  ment, or carefully drawn
  plan for disposal or con-
  tinuation of the business.
• An estimate of the funds re-
  quired to carry out the
details of the plan.

Consultation between the pro-
prietor’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 par-
ticular case.

What the plan will involve, what
kind of insurance is suitable, and how
it will be set up, depends on such fac-
tors 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 con-
tinue a business after the owners death,
business life insurance for sole pro-
prietorships 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 per-
sonal 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 pro-
prietor’s death.

**Corporation Life Insurance**

In the case of a corporation, life in-
surance 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.

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 satisfied 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 decedent’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.