

MassMutual

Business Succession Planning

Al Kingan, JD*, LLM, CLU®, ChFC®
 Estate and Business Planning | Advanced Sales Lead -
 MassMutual

Unified Virginia Chiropractic Association Fall Convention

*Licensed, not practicing on behalf of Massachusetts Mutual Life Insurance Company

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1

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2

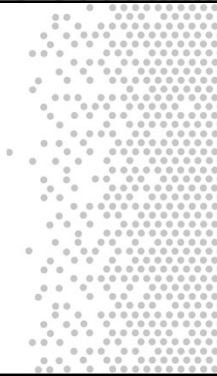
What Will You Learn Today

- Business Succession
 - What will happen to your business
 - Transfer Options
 - Buy-Sell Planning Options and Structure
 - Disability Planning
 - Valuation Issues
- Estate planning
 - Planning, Process and Taxes
 - Documents that you need
 - Insurance

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3

The Importance of Coordinating Business and Estate Planning



4

Create a Team

- You
- A financial professional
- An accountant
- An estate and business planning attorney
- A business appraisal/valuation expert*



*MassMutual does not provide qualified business valuations. For a qualified or certified business valuation, consult a properly credentialed appraiser.

5

What's on Business Owners' Minds?

Income
Business Loans
Employees
Transfer
Estate Planning

Critical Questions...

- How would you or your family maintain your standard of living in the event you die, become disabled, or retire?
- What happens to outstanding loans if you die or become disabled?
- Who would you take with you if you started a new business?
- What do you want to do with the business when you are ready to exit?
- Should you be concerned about Federal or State gift or inheritance taxes?

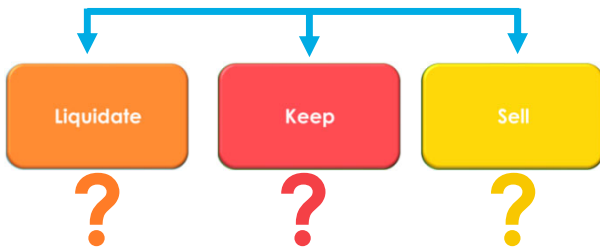
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What Will Happen to Your Business Absent Planning?

- Your ownership interest will pass under your WILL.
- Typically, if you are married, it will pass to your spouse.
 - Does your spouse want to be an owner?
 - Is he or she qualified for the role?
 - Perhaps they have their own business and do not have the time or interest.
- Are there other owners?
- How do they feel about your spouse becoming an owner?
 - What impact will this have on your families financial situation?

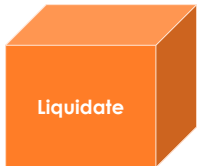
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What Do YOU Want to Happen to Your Business?



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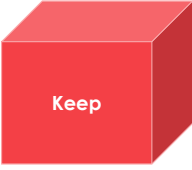
LIQUIDATE the Business?



- Perhaps there is no successor?
- Who will buy?
- At what price?
- How much value will be lost?
- What happens to family income?

9

KEEP it in the Family?




- Are children in the business now?
- Can one or more run it successfully?
- Bequest/Gift/Sell?
- What would inactive children or your spouse get?
- How to cover estate taxes?


10

10


Three Ways That a Parent Can Pass a Business Interest on to the Next Generation



Bequest



Gift

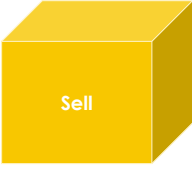


Sale

11

11

SELL the Business?



- When?
- To whom?
 - Other owners,
 - Key employees,
 - Children.
- At what price and how do they pay?

12

12

Buy-Sell Agreements

When to Sell, Who Will Buy, at What Price?



Arms-Length Agreement

13

13

Business Succession Planning – Buy-Sell Planning

Three Issues:

Structure of Buy-Sell Arrangement	Value	Funding
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14

14

Business Planning: Buy-Sell Arrangements

Contract between business owners that dictates what happens to the business in the event of death, disability, or leaving the business

- Gives triggering events
- Funded with disability income and/or life insurance
- Details purchase price or how to calculate price
- States who can buy shares

15

15

What is a Buy-Sell Agreement - Objectives

- Provide a market for the owner's business interest
- Separate family's financial security from business
- Eliminate interference and conflict with remaining owners
- Protect against transfers to unwanted third parties
- Provide price, payment terms and method of funding
- **May** help "peg" estate tax value
- Ensure a smooth transition

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16

Why Life Insurance as Funding Vehicle in a Buy-Sell Agreement

- Life insurance, if properly used and constructed, can be a means to provide the liquidity needed to buy the interest or stock from a partner/co-shareholder at death, disability or retirement.
- The death benefit is paid on-time, untouched and untaxed if designed correctly and if state asset protection laws allow.
- When the owner/insured passes away, the proceeds are received, generally, income tax free.
- They are received when you need them after the person dies to continue the business and provide monies for the deceased's family

⋮ 17

17

How and Why Insurance Can Be Used in Estate Planning – Business Planning

Buy-Sell Planning Example

Jane and Julie are equal business partners in J&J Chiropractors. They are both married. They have decided that in the event that one of them dies, becomes disabled, or retires, they would like the other to own 100%

How do they do this without disinheriting the surviving spouse of the deceased owner?

- Life insurance and a buy-sell agreement
- Apply for life insurance for the amount of the business interest
- The survivor of Jane and Julie will use the death benefit on the other to purchase the business from the decedent's estate

⋮ 18

18

Business Succession Planning – Buy-Sell Planning

Structure of Buy-Sell Arrangement

- Cross purchase
- Entity redemption

What should be covered?

- Death
- Disability
- Retirement or other termination
- Admitting new members/partners/shareholders
 - Only licensed professionals may be owners – limits options and universe of interested buyers

19

Classic Buy Sell Scenario

Cross Purchase in Action

At inception

In the event of death or disability

20

Classic Buy Sell Scenario

Entity Purchase in Action

At inception

In the event of death or disability

21

One owner: Sale to Key Employee

One-Way Buy Sell – Pat is owner and Fran is the key employee

- Owner and Key Employee enter into agreement to have key employee buy out 100% owner
- Key employee owns a policy on business owner's life

Problem: Money Solution: the business pays the premium

- Business bonuses premium to key employee (term policy)
- Business loans premium to key employee (permanent cash value policy)
 - Loan is secured by a collateral assignment

22

22

Structures and When They Apply

Entity Purchase vs. Cross Purchase

	Entity Purchase	Cross Purchase
Purchaser	Corporation	Surviving Stockholders
Seller	Deceased Stockholder's Estate/Disabled Stockholder	Deceased Stockholder's Estate/Disabled Stockholder
Policy Owner	Corporation	Individual Stockholders
Number of Policies Needed	One Per Shareholder	Multiple

23

23

Structures and When They Apply

Entity Purchase vs. Cross Purchase

	Entity Purchase	Cross Purchase
Premiums	Paid by business/not deductible	Paid by stockholders/not deductible
Taxation of Death Benefits	Income Tax-Free	Income Tax-Free
Effect on Surviving Stockholders	Value of stock owned increases (no increase in basis)*	Basis increases by amount paid for disabled/deceased owner's stock

*Partial Increase for S Corp shareholders.

24

24

Slide 23

BK0 Do slides 23 and 24 apply to both life insurance and disability income insurance?

Brunnett, Kamala, 2022-09-08T12:50:15.656

KA0 0 Actually they would. Interestingly, I rarely talk about disability insurance unless someone asks a question.

Kingan, Al, 2022-09-08T18:49:31.455

BK0 1 Please work this into your speakers notes so it's clear the information pertains to both life and DI insurance.

Brunnett, Kamala, 2022-09-09T15:44:10.810

KA0 2 Done. thanks.

Kingan, Al, 2022-09-09T17:55:05.834

Disability Insurance Buy-Sell

What is Disability Insurance Buy-Sell?

A disability income insurance policy can be used for small business owners to provide funds for:

- The purchase of the insured's share of ownership in the business in the event that one of the owners becomes totally disabled;
- A funding vehicle for the disability portion of a buy-sell arrangement

25

Disability Insurance Buy-Sell

Advantages to Healthy Owners

- Business interest of the disabled owner can be obtained at a fair price
- Maintains 100% ownership and control of the business
- No need to funnel business profits to support disabled partner
- Benefits payable from buy-sell are typically tax-free

Disadvantage

- Disability Policy premiums are not tax deductible

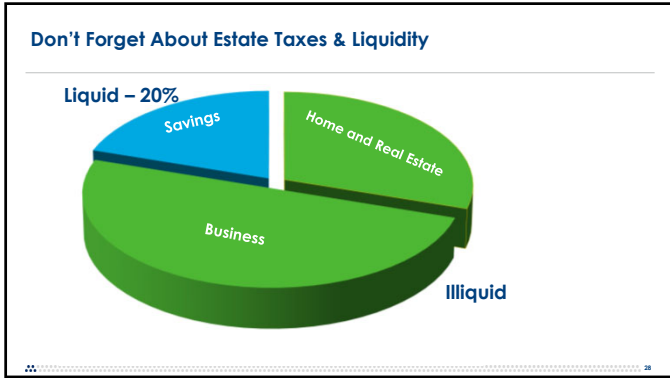
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Disability Insurance Buy-Sell

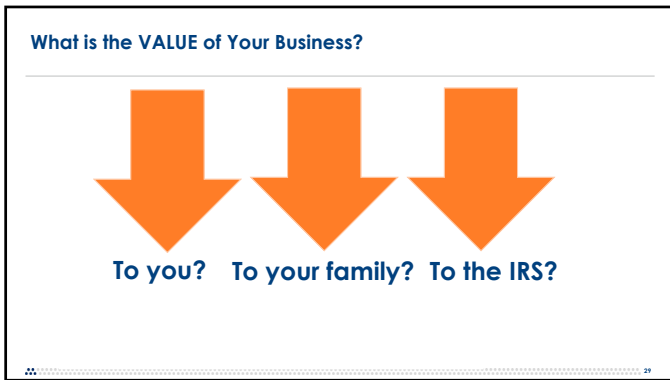
Impact to Owners with Disabilities

- Allows owner with disability to concentrate on their own health and not worry about the business
- Provides up to a specified amount for their share of the business
- No legal responsibility for potential future losses of the business
- Taxed only on the capital gain from the sale of the business

27



28



29

Business Succession Planning – Buy-Sell Planning

Valuation

Non-professional practices often use book value to help determine buy-out value

- In professional practice, book value is merely the depreciated value of furniture and equipment, plus cash and other property, less debts
- Professional practice – use of “cash” method of accounting results in three valuable assets not even appearing on balance sheet:
 - Accounts receivable
 - Goodwill
 - Work in progress

30

Business Succession Planning – Buy-Sell Planning

Typical Valuation Methods

- Agreed Dollar Value
 - Value should be reviewed and updated regularly
- Formula value, such as a percentage of future income
 - Formulas may be subject to manipulation
- Fair market value plus a multiple of past earnings
- Capitalization of average yearly earnings
- Book value plus value of goodwill
- Professional appraisal

31

31

Business Succession Planning – Buy-Sell Planning

Typical Valuation for Living Buy-Out

<p>Terminating Professional's Share of:</p> <ul style="list-style-type: none"> • Book value • Likely collectible receivables • Work in progress • Goodwill??? 	<p>Funding Buy-Out</p> <ul style="list-style-type: none"> • Future profits • Cash values of life insurance/DI buy-out policy • Personal assets
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32

32

Business Succession Planning – Buy-Sell Planning

Typical Payout Methods

Sale at Death

- Lump sum based upon life insurance proceeds available
- Installment or guaranteed payments over period of time

33

33

Planning for the Professional Practice – Business Succession Planning

Possible Insurance Needs

- Life for buy-sell purposes
- Life for key-person purposes, pay off business debts, etc.
- Life for family income replacement
- Life for estate tax planning
- Individual disability income insurance
- Disability buy-out insurance
- Business overhead insurance

34

34

Estate Planning

A **lifetime process** of building, managing, protecting, using and eventually transferring assets to whom you desire, in the **most efficient** manner.

35

35

Estate Taxes

Federal Estate Taxes
are due
in cash
in nine months.

36

36

2022 Federal Estate Tax Table*

Taxable Estate	Subject to Estate Tax
Under \$12,060,000*	\$0.00

*Indexed for inflation. Under the 2017 TCJA, estate tax exemption sunsets after 2025

Good News: Virginia has NO Estate or Inheritance Tax

37

Annual Lifetime Gifts

The diagram shows an orange cube labeled "\$14,000 (2022)" and "Parent" on the left. A red arrow points to a taller yellow cube labeled "Gift and Appreciation" and "Children or Trust" on the right.

38

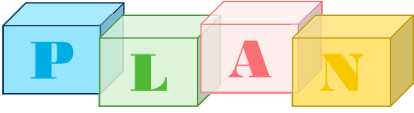
Exemption Gifts

The diagram shows an orange cube labeled "\$12,060,000 (2022)" and "Parent" on the left. A red arrow points to a taller yellow cube labeled "Appreciation is out" and "Children or Trust" on the right.

39

Everyone has a Plan...BUT...

- Most people's plans are in their head
- The rate of death is 100%
- "Understanding" can lead to "miss-understandings"



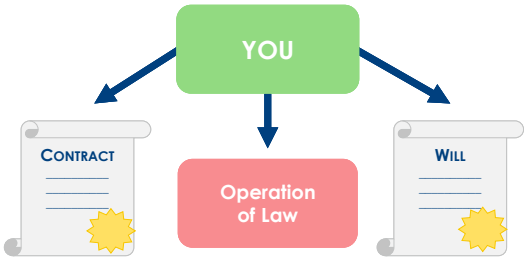
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Employee Benefits and Retirement Accounts

- 1. Personal Property**
Savings
Stocks Bonds
Personal Effects
- 2. Real Estate**
Home(s)
Commercial Investment
- 3. Employee Benefits**
Pension
401 (k)
IRA Stock Options
- 4. Insurance**
Life
Health
Annuities
Disability
Income
- 5. Business Interests**
C/S
Corporations
Partnerships
LLCs

41

How Property Passes at Death



42

What is Probate?

Probate insures distribution of assets according to will instructions

- Individually owned assets
- Joint tenancy assets at surviving joint tenant's death

Advantages	Disadvantages
Limits time to challenge/make creditor claims against will	Time
Supervision of executor/guardian	Expense
	Publicity

43

Assets That Pass Outside Probate

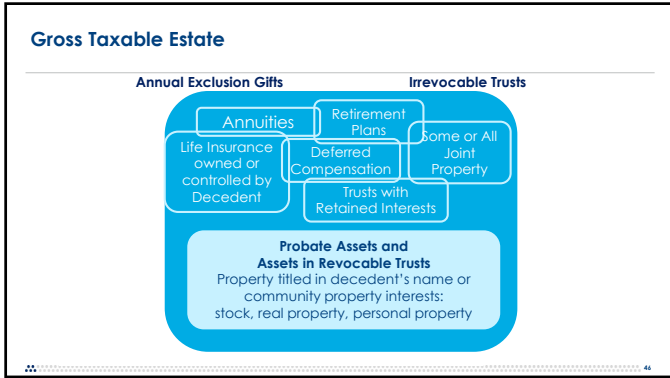
- Joint tenancy
- Assets subject to beneficiary designation (pass by contract)
 - Life insurance
 - Annuities
 - Qualified plans
 - IRAs
- Assets owned by a revocable living trust

44

Revocable Trust

- Avoids probate
- Ensures privacy
- Trustee provides asset management during incapacity or after death
- Avoids delay
- Avoids will contests
- May be drafted as the primary tool of asset distribution (with pour-over will)

45



46

Important Documents You Need

A **Will** is a legal expression of your wishes as to who gets your assets at your death

- Appoint guardians of minor children, and any wishes for that guardian on raising your children
- Trusts can be created via will (aka: a testamentary trust), or a Will can direct assets to be poured-over to your revocable living trust (that became irrevocable at death)
- Choose executor

47

Important Documents – Health Care Proxy

A **Health Care Proxy** is an instrument (or document) that allows a patient to appoint an agent to make health care decisions in the event that the primary individual is incapable of executing such decisions

- o Some jurisdictions limit who can be named as agent (state specific)
- o May or may not be mandatory to be followed (state specific laws)
- o Some states call it "health care power of attorney"
- Terri Schiavo case – prime example

48

Important Documents You Need

A **Durable Power of Attorney** is a common type of power of attorney where the power to act on the signer's behalf will still exist even if the signer becomes incapacitated

- Without a durable power of attorney, a friend or family member of someone who has become incapacitated would have to petition a court in their state for the authority to act on behalf of the incapacitated person

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49

Estate Planning – Deductions and Exemptions

Deduction and Exemptions

- **Unlimited marital deduction** – ability to transfer all assets at death to surviving spouse with no estate taxes due
- **Estate tax exemption** – Amount that each person can have at death without having to pay estate taxes
- **Annual gift exemption** – Amount that each person can gift on a yearly basis without using any of the lifetime gift exemption
- **Lifetime gift exemption** – amount that each person can gift away during his or her lifetime

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50

Estate Planning – Personal Planning

Credit Shelter Trust

- Used by married couples to pass assets for the surviving spouse and heirs that will not be includable in the surviving spouse's taxable estate
- Each spouse can put up to the estate tax exemption amount into his or her trust
- Set up trusts while both spouses are alive
- Typically funded at death of first spouse

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51

Estate Planning – Personal Planning

Portability

- The second spouse to die can use leftover estate tax exemption from first spouse at his/her death if any
- Must be elected by executor
- Estate tax return must be filed documenting the available exemption amount

52

How and Why Insurance Can Be Used in Estate Planning – Personal Planning

Marital A/B Trust

- Credit shelter trust (B) – Surviving spouse and possibly children are eligible beneficiaries; funded with unused estate tax exemption amount (currently \$12,060,000)
- Marital trust (A) – Surviving spouse is sole beneficiary during his/her life; then to children/grandchildren
- Can be set up for one or both spouses

53

**Estate Planning – Personal Planning
Irrevocable Life Insurance trust (ILIT)**

- Type of trust most often used to hold insurance policies for individuals with taxable estates
 - Helps minimize size of taxable estate by keeping life insurance proceeds out of taxable estate
- **Goals of ILIT** : sum of money available at grantor's death that can be used to help pay estate taxes and other administrative expenses or to transfer wealth across generations.
 - Trust assets are not used to directly pay such expenses
 - Trustee either makes loans to estate or purchases assets from estate, providing Executor with liquidity to meet estate cash flow need
- Irrevocable = assets in trust no longer belong to grantor after being gifted to ILIT

54

Irrevocable Life Insurance Trust (ILIT) continued

Common Goal of ILIT : Death benefits and other trust assets available at grantor's death that can be used to help pay estate taxes and other administrative expenses.

- Trust assets are not used to directly pay such expenses.
- Trustee either makes loans to estate or purchases assets from estate, thereby providing Executor with liquidity to meet estate cash flow need.

55

Steps to Be Taken

- Review your present situation and plans.
- Focus on your true goals and objectives
- Consider business and estate planning alternatives.
- Determine what taxes, losses and conflicts could occur.
- Have legal instruments drafted.
- Decide how to fund your plans or cover taxes.
- Review plan annually with your professional advisors.

56

The Biggest Hurdle: COMPLACENCY

- What do you want to happen?
- What would happen?
- Can You Afford to Stand Still?



57



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