

White Paper – Life Insurance for Business Owners

Life insurance in its simplest terms is a contractual promise between an insured (and in some cases a policy owner as well) and an insurance company to pay a death benefit at the time the insured dies. Of course there are exclusions at least in the first couple years after issue for payment on claims related to suicide, which helps to prevent fraudulent purchases. There are also uses not as common for life insurance, and they include among other things to fund various transactions required within a business environment at the time of the insured's death.

The reasons people get life insurance vary, most typically they are to replace the lost income of the deceased insured. Another key reason for owning life insurance is to pay for final expenses related to passing away and being buried. These are the two main reasons people get life insurance, however they are far from the only reasons. For the purposes of this paper we will focus on reasons why business owners purchase policies. As you will see there are several reasons just among business owners which go far beyond the primary life insurance purchaser reasons. These are all legitimate reasons for coverage and can be the difference for a company surviving the passing of a key employee or owner or not surviving.

Life insurance for business owners provides several different opportunities to provide safety and reward at the same time, depending on the specific policy use. When it is used for reward it carries a safety net as well. Often insurance payments are used to provide the cash needed to recruit and replace a key employee or to pay off an estate in the event of a partner's death. In each of these cases the business owner(s) are protected against the loss of a key employee/partner where the death could otherwise result in a serious financial hardship for the company. In other uses the insurance policy is a vehicle to protect a sum of money placed in as deferred compensation that provides a large death benefit as well.

If one key sales person brings in half of the company revenue and (s)he dies that could cause serious revenue side financial problems for the company and its owner(s). When a partner dies, the cash needed to buy out their estate may create a financial hardship on the other partners or the company itself. Thus these are two scenarios where the owners can use life insurance to help the company survive the cash flow issues associated with such a death.

Another reason that a business owner will buy life insurance is to provide it as an employee benefit to the employees working there. The cost of the first \$50,000 in coverage is a tax deductible business expense, and amounts over \$50,000 in coverage generate imputed income for the employee. This is a low cost benefit in most cases for the employer to provide to employees and tends to help retain employees who may not get benefits elsewhere they would go. When the company is large enough the employer can cover a base death benefit while offering voluntary additional life insurance to those same employees.

There are of course other reasons a business owner him/herself may want to have life insurance coverage. These other ways are more of a think outside the box type of use for the policy, but they are

legitimate uses for life insurance, which are tired and true. Executive bonus and deferred compensation plans are a great opportunity to use a life insurance policy for alternative benefits while providing protection in the event of an untimely death. By using the right kind of insurance the policy owner and the employee can both reap rewards from growing the policy value while alive and tapping into the value of the policy thru tax free loans later in life. In the event of the employees death the death benefit then go to their designated as a beneficiary so the deferred compensation or bonus is not lost by the family of the person who earned the compensation.

When using a life insurance policy, the money given as a bonus or deferred compensation is used to buy the life insurance or pay in additional premiums to a policy already established for this purpose. There are a few ways to structure payments depending on goals with regard to taxation of the premiums paid on behalf of the employee. Another factor that comes into play is how many owners are involved in the company when working on this kind of insurance strategy. The real benefit to these structures is that money is taken out for use in retirement from the policy, or it could be left behind to grow into an even larger legacy for heirs.

The money withdrawn from the policy is taken in the form of policy loans. These policy loans are not taxed they do lower the value of the death benefit payout since ultimately the policy loan and interest must be repaid from the death benefit. Because these numbers are known or planned at the time of the policy purchase everything, including the loans taken out from the policy and the interest expense can all be calculated ahead of the purchase. Such calculations can allow backwards figuring of the needed premium to provide a string of payments at a particular future time. So if you want to produce \$100,000 in annual income in retirement, then that is going to be the basis used along with assumptions that are agreed upon to come up with the necessary premiums.

Because these benefits are tax free at the time of withdrawal it takes less premium set on a guaranteed growth basis to reach the output desired income string. The premiums though must be taxed since both the premium and death benefit cannot sit in the same tax status on a policy such as this. The tax must be ultimately paid by the employee at the time of the premium payment to the insurance company. Of course the company can gross up the payment for the premium to include that which is owed as taxes as well.

There are some common steps involved in securing a life insurance policy. Generally the first step is deciding (and this should be with the help of your broker) how much coverage is needed, and why the coverage is being purchased. Next a screening of medical history takes place to ensure that the most appropriate carrier is selected for policy placement. Third step is completion of an application. The fourth step is to have the application underwritten. Once underwritten and the policy is officially offered by the insurer, the final step is acceptance of the policy as issued acknowledging receipt of the policy and pay then ongoing premiums.

Once you have selected the most appropriate policy and complete the application you go thru the underwriting process. The underwriting process is where the insurance company evaluates your stated need for insurance, your current income and wealth accumulated, and your health history to determine

if you meet their internal underwriting criteria to get a policy. The underwriting process will also evaluate if you are provided with a policy at standard rates, better than standard rates, or at rates above the standard rates. (Some of this can be predicted in the initial prescreening step of the policy acquisition process.) Underwriting is not the same between different insurance companies. Each can set their own risk tolerance which does tend to make some carriers better for select groups of people while other carriers are better for others.

When the application is submitted the underwriting team will first validate the information submitted. This involved checking some national databases that show specific medical conditions and medicines for individuals in the USA. Then depending on the amount of insurance and level of risk to the insurance company medical records, EKGs, and Blood Work may be requested by the underwriter. Either the insurer or the broker will set up the paramed who come out to see you and gather the samples. The insurer or broker will also arrange to get medical records from your doctor as needed.

The underwriting process typically takes one to two months, sometimes longer. The shorter processing times are usually for smaller policies or in situations where no medical records are needed. When the doctor's office expedites medical records to the carrier for review, it can help speed the process along. Other factors that may affect the speed of the underwriting process is the ability of the insured to carry out any medical review and blood work provisions of the underwriting for the policy. The faster each step is done the quicker generally the entire policy is issued.

All of the information will be compiled and form an overall health and financial status. Based on your status on each item you're assigned points which will determine where you end up on the carriers rate table for either preferred, standard, or rated coverage. Then depending on the amount of coverage desired, and if the stated reason and income justify that level of coverage (in other words someone making \$30,000 per year with no wealth accumulated can't easily secure a \$25,000,000 death benefit) then a rate is calculated. Rates generally decline on a cost/per thousand dollars coverage level, as the amount of coverage increases.

When all of these above steps are completed and the insured is acceptable to the insurer, a policy offer is provided to the insured (and/or insurance policy owner). At that point the broker will bring the policy to the purchaser for signature and delivery. If the final offer from the insurer is acceptable you then sign and pay for the policy and it is effective. In some cases you may pay a premium with the application and if the application is accepted as written or at better rates the policy is issued and effective already when delivered.

There are several kinds of life insurance available and they are able to be used for many kinds of coverage needs. When structured correctly life insurance can help fund retirement, college, or to pay estate taxes. For some a life insurance policy is a way to leave behind a legacy to your favorite charity. A permanent policy for a newborn baby is a good gift. All of these uses are options with a permanent life insurance.

We at [Brooks Insurance Services](#) are able to help with any of the above policies. Just give us a call and let us know what you are looking to do, then together we can put together the best solution based on your specific needs.