

**Advanced Markets**

**how will  
my business  
succeed?**



**business  
continuation  
with life insurance**

Life Insurance: · Is Not a Deposit of Any Bank · Is Not FDIC Insured · Is Not Insured by Any Federal Government Agency · Is Not Guaranteed by Any Bank or Savings Association · May Go Down in Value

**redefining / standards<sup>®</sup>**



## **make sure your business thrives, no matter what**

Your vision made it a reality and your hard work built it. Your business is probably both a tremendous challenge and a source of personal satisfaction. It is also likely the cornerstone of your family's financial security. Now you need a plan to keep your business going, on your terms, no matter what. AXA can help.

# protect your business and your family

Whether your business is a one-person operation, a partnership or a closely held corporation, a business continuation plan should be a component of your overall strategy. You can't predict the future, but you can make plans now, to ensure your business lives on as you want it to.

When it comes to a business continuation plan, it's important to answer these two questions

- What would happen to my business if I (or my partner) were to die today?
- Would my family's need for income and funding for their future plans be met if something happened to me today?

Your business continuation plan will also depend on whether you are an individual owner, or if there are multiple owners.

## For Individual Owners

If you're a sole proprietor, you will want to decide whether the business continues, with a family member or someone else at the helm, or if it closes its doors. Determining whether the business is to continue requires the consideration of a number of factors. For example:

- Is your spouse involved in or interested in your company?
- How old are your children? If they are years away from adulthood, who will carry on the business?
- Are there any grown children in the business?

It's important for you to discuss these issues with your family and review these plans periodically as circumstances change, for both your family and your business. Having a plan in place now will help make the transition for your business easier for everyone involved – your family, your employees and your clients.





## For Co-Owners

For closely held businesses of all kinds, preparing for the orderly transfer of ownership interests when one of the owners dies can provide assurance that the business will continue as the current owners see fit. Such an agreement, known as a buy-sell agreement, describes the terms for the co-owners (or the business itself) to buy out the deceased's interest or redeem stock. It states how the value of the business is to be determined, the circumstances in which a buyout is to occur, and how the agreement is to be funded.

### **A buy-sell agreement has several benefits to your business:**

- You, individually, or as part of the current management, can to retain control of the company.
- You actively choose the successors of your business.
- You don't want to have to worry about the family selling their interest in the company to an outsider not of your choosing.
- You can ensure a reasonable buyout price — either one that is predetermined or by using a set valuation method to arrive at one.

### **A buy-sell agreement also carries benefits for your family:**

- Your family avoids an uncomfortable arrangement working with your business partners.
- A ready buyer for your interest in the company, if something happens to you.
- Fair compensation for your hard work in the business.
- Timely payment of their share of the business, in order to meet their financial needs.
- Financial security, regardless of the future success of the business.

A well-crafted buy-sell agreement can potentially serve all your interests as a business owner and as a family provider by ensuring the continuation of the business and providing your family with the financial compensation they are due in the event of your death. There are several different types of buy-sell agreements. You should enlist professional legal help to create the best agreement for your particular business situation.

## Tying a dollar amount to your business

Many business owners don't know the true market value of their business. For this reason, it's a good idea to engage a professional valuation specialist to determine an accurate going-concern value of your business today. These specialists are trained to use different methods and metrics, including comparable recent sales and discounted cash flow analysis, to arrive at a reasonable fair-market value. The value they establish can be useful in creating business continuation agreements, such as a buy-sell agreement.

For companies of all types and sizes, hiring a certified valuation firm may be a sound investment, whether or not you are considering an exit event in the near future. The firm's fee normally is tax-deductible for your company. In addition to supporting your strategic planning, the appraisal can be useful for your personal planning.

Only one-third of family-owned businesses survive the transition to the second generation. A primary reason for this dismal survival rate lies in poor succession planning.

*Money Management*, New York State Society of CPAs.



**To provide additional guidance, the IRS issued Revenue Ruling 59-60, itemizing eight factors to be considered in determining fair market value:**

- 1** The nature of the business and its history
- 2** The economic outlook in general and for the specific industry
- 3** Book value of the business and its general financial condition
- 4** Earnings capacity
- 5** Dividend-paying capacity
- 6** Goodwill
- 7** Recent sales of an interest in the business and the size of the interest to be valued
- 8** Market price of similar publicly held businesses

# how life insurance can help

Life insurance protection can make a difference in a successful business plan. It also gives important financial security for your family. Life insurance benefits are generally income-tax-free and payments are immediate.

## For Individual Owners

Having a source of funds on hand for your family to implement your plans makes the transition easier, not just financially, but emotionally, as well. In the absence of a family member capable of stepping in and willing to take on your role, there are generally three options:

- **Liquidate the Business** – Even with careful planning, circumstances may necessitate the liquidation of a business. In this instance, life insurance proceeds can make up the difference between the auction block price of your business assets and the true value of your company as a going concern.
- **Sell the Business** – In this scenario, life insurance proceeds can make up income lost by your business in your absence and help ensure that financial obligations to creditors and employees are met. Both are important factors in maintaining the company's value and credit rating while your family finds a suitable buyer. Your family can also receive money to replace your income, particularly important if you were a breadwinner or vital financial contributor to the family.
- **Maintain Ownership and Hire Someone to Manage the Company for the Family** – This might be a permanent strategy or a temporary measure for a

younger family, perhaps to allow time for children to grow up. Here, life insurance proceeds can keep the business and your family on an even keel while a suitable person is found. Money will be available to pay for the costs of the search and make up for income lost during the transition period. If the new manager comes from within the company, there will be money on hand to search for and train a replacement to fill his or her previous position.

We have a wide range of planning approaches to help retain management during difficult transition periods.

### all in the family

Life insurance can also be used to equalize bequests in a situation where one sibling is taking the helm of a family business and another, with different talents and interests, has other career plans.



## For Co-Owners

In order to execute a buy-sell agreement, a source of funds must be identified for the buyout. In many respects, choosing this source of funds is as important as the agreement itself. Arranging the specifics of who buys what, when, and at what price is meaningless if money is difficult to obtain, or simply not available. Without proper funding, the buy-sell agreement may be relatively worthless.

There are several different possible sources of funds for a buy-sell agreement. The owners could use cash, or set aside a fund to save for the buyout. This is generally not the preferred method for many businesses because of the large cash flow required, which could be used for reinvestment into the business. An installment payout may be another option, where the surviving owners work out a schedule of payments to the family. The drawback to this method is that the family must wait to receive full payment, with no guarantee that the company will be able to pay off the entire sum.

Use a buy-sell agreement to ensure that funds are provided to allow remaining owners to buy the deceased's portion of the business.

Without planning, an installment payout is the likely scenario. In addition to burdening the company, probably already weakened, with a sizable debt, this method means the family must wait to receive payment. And, there is no guarantee the company will be able to pay off the entire sum. If the business fails, where does that leave the family?

As you can see, problems associated with any of these funding options could threaten the solvency of the business, and default on installment payments seriously threatens the financial well-being of the family.

## Using Life Insurance for a Buy-Sell Agreement

Life insurance as a funding tool can give flexibility to meet the arrangements of the buy-sell agreement. The policies can be purchased to cover all the owners, either by the principals to cover each other, or by the company to cover all. At the death of one of the owners, the life insurance benefits paid on the policy (or policies) are used to buy the deceased owner's interest from his or her family. Life insurance is unique in that it can guarantee<sup>1</sup> the amount of money for the buyout will be available precisely when it is needed<sup>2</sup> — whether the agreement has been in effect for a few months, a few years or a few decades.

Premiums are regular and therefore budgeted. The life insurance benefit is generally income-tax-free, although premiums are not tax-deductible. Your tax professional can advise you regarding your company's particular tax situation. At the death of an owner, life insurance proceeds can expedite full and timely payment to the surviving family. The business continues with the surviving owners in control. The face value of the policy can cover only the buyout or a larger face amount can be purchased — to cover the company's lost income, extra expenses related to losing an owner, or to retire debt.

A permanent life insurance policy has some added advantages over a term insurance policy. It allows for the tax-deferred buildup of cash value. This asset can help enhance the company's credit rating, and can be used in an emergency to pay for unforeseen expenses. If a partner chooses to leave the company (within the terms of the buy-sell agreement) or retire, the cash value can be used, at least, to provide the down payment on a buyout.<sup>3</sup>

It's a good idea to draw up a buy-sell agreement right at the outset of your venture. If you choose life insurance to fund the agreement, the earlier the policies are obtained, the better, since premiums increase with the age of the person to be insured, and your health may deteriorate. However, if you don't have a buy-sell agreement in place, think about drafting one now.

A buy-sell agreement should be reviewed regularly, and the face amounts of any policies funding it should be increased as the value of the company increases. A policy used to fund a buy-sell for a startup business would be totally inadequate for a company that has grown into a multimillion dollar operation.



<sup>1</sup> All guarantees are based on the claims-paying ability of the issuer.

<sup>2</sup> Provided insurance contract remains in force.

<sup>3</sup> Accessing a policy's cash value through withdrawals or loans will reduce that cash value and the death benefit, and increase the chance the policy may lapse.

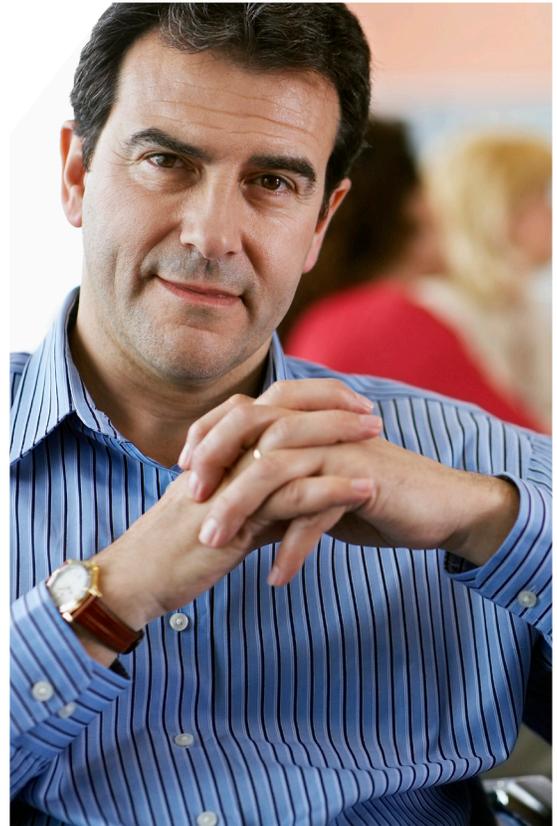
## The Value of a Multi-Disciplinary Team

You may need several types of professionals, working together, to plan for a full-value exit. They include:

- **Legal advice, including help in drafting a buy-sell agreement**
- **Accounting services and tax advice from a qualified CPA**
- **Business valuation expertise**
- **Estate planning guidance**
- **Investment and insurance planning and services**
- **Business consulting**

A coordinated planning process can help you turn the *hope* of a full-value exit event into a realistic *plan* with clearly defined action steps. It also will motivate you to communicate clearly with your team of advisors about how to convert your business equity into personal wealth, tax efficiently.

Finally, this process can help you work toward other goals, such as increasing access to capital, protecting against the loss of key people, and meeting IRS requirements for valuing gifts and estate transfers.



## How to Take the Next Step

The next step may be a fact-finding session, in which we can help you define business and personal goals and full-value exit strategy options, on a schedule that feels comfortable.

We have the experience to guide your planning and coordinate your multi-disciplinary professional team. We look forward to learning more about you and your company.





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1290 Avenue of the Americas, New York, NY 10104, (212) 554-1234



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