EQUITABLE

Using life insurance to fund a retirement buy-sell arrangement

Advanced Markets

A case study

Help your clients prepare for the transition of their business and plan for the rest of their lives

Have your clients thought about what might happen to their business if either they or one of their co-owners passed away, became disabled, decided to leave the business or simply wanted to retire? Have they set aside enough money to retire comfortably? See how Nathan, Zack and Alex manage these issues.

Meet the Brightens, siblings and one-third owners of Wilderness Ventures, LLC

Nathan
Age 50

Zack
Age 45

Alex
Age 40

The Brightens have discussed the future of their business and here is the situation:

Their business is appraised at $6,000,000 and estimated to double in value over the next decade.

The owners agree that they don't want to add any additional owners to the mix, so they are considering a buy-sell arrangement in which each owner would sell his shares to the other owners in the event of death, disability, disagreement between owners or retirement.

Given today's high tax rates, they are looking at permanent life insurance as a tax-efficient means of accumulating cash value to potentially supplement their retirement income.

Recognizing the high cost of healthcare, especially long-term care, they want to protect themselves with a long-term care rider on the policies.

Who's an ideal candidate for a retirement buy-sell?

- Co-owner of a business
- Wants to plan for business transition
- Needs retirement income as well

How does the retirement buy-sell arrangement work for them?

Since their business is growing, the Brightens decide to initially fund their buy-sell agreement based on a projected value of $9,000,000. Each owner purchases a $3,000,000 BrightLife® Grow indexed universal life policy on himself, with the Long-Term Care Services℠ Rider. Each owner then endorses $1,500,000 (50% of the death benefit) to each of the other two co-owners and receives a rental cost from the other two, equal to the appropriate TermOne® alternative rate.

What happens when Nathan passes away?

- At the time of Nathan's death at age 60, the death benefit on his policy passes equally (and tax-free) to Zack and Alex, as specified under their agreement.
- The proceeds are used by Zack and Alex to purchase Nathan's share of the business from his estate.

Added bonus: an increase in cost basis for Zack and Alex

Because they purchased the shares of the business from Nathan's estate, Zack's and Alex's cost basis in the business will increase by the amount of the purchase price. Since they started the business from nothing, their cost basis had been zero. But now Zack and Alex each own 50% of the business and their cost basis is $1,500,000 (each), because that is what they paid Nathan's estate for Nathan's shares. That means, if Zack and Alex sell the business, they could each potentially save $300,000 (20% of $1,500,000) in capital gains taxes.

What happens when Zack and Alex decide to sell the business?

- After Nathan's death, the business slows down.
- At age 65, Zack has health issues and is no longer able to work on a regular basis.
- Alex attempts to run the business himself for a brief time and realizes, at age 60, it is simply more than he wants to manage.
- They sell the business for $5,000,000 — each sibling receiving a $2,500,000 (at 5% interest with a 10-year balloon) note from the new owner.

What happens when Zack becomes disabled?

- By age 70, Zack is unable to care for himself and goes to an assisted living facility.
- Zack's wife remains at home, living off the payments from the sale of the business.
- To pay for Zack's long-term care obligations, Zack utilizes the benefits from the Long-Term Care Services℠ Rider on his BrightLife® Grow policy.

See the strategy in action

Zack — $3,000,000 retirement buy-sell plan

Age	Premiums	Cash surrender value	Death benefit	Maximum LTC benefit	Economic benefit of Nathan's policy	Economic benefit of Alex's policy
45	$61,051	$0	$3,000,000	$3,000,000	$1,273	$722
50	$61,051	$226,964	$3,000,000	$3,000,000	$1,448	$795
55	$61,051	$630,051	$3,000,000	$3,000,000	**$1,711**	$1,007
60	$61,051	$1,236,245	$3,146,244	$3,000,000	$0	$1,290
65	$61,051	$2,062,032	$4,470,485	$3,000,000	$0	**$2,559**
70	$0	$2,819,540	$5,252,802	**$3,000,000**	$0	$0
80	$0	$5,054,852	$7,223,384	$3,000,000	$0	$0
100	$0	$16,494,532	$17,038,851	$3,000,000	$0	$0

Zack can take up to $30,000 per month in LTC benefits.

Nathan dies at age 60.

Zack and Alex sell the business.[1]

1 The retirement buy-sell is no longer in effect.

This is a supplemental illustration and must be read in conjunction with the basic illustration. The basic illustration contains values using the same underwriting assumptions as this supplemental at both guaranteed charges and guaranteed interest rates and contains other important information. The values represented here are for a $3,000,000 BrightLife® Grow policy on a 45-year-old male preferred non-smoker. The values reflect the cost of 20 years of premiums. The values represented here are nonguaranteed and assume current charges and a current interest rate of 6.31%. If guaranteed rates and charges are used, the policy would fail in year 25.

What happens when Alex needs supplemental retirement income?

Alex got used to a high standard of living while the business was successful. Now, he finds it difficult to get by on the money received from the sale of the business. By age 70, he has spent most of the $2,500,000 received from the sale of the business and is struggling to maintain his lifestyle on his 401(k) and Social Security benefits. To help maintain his standard of living, he begins to take distributions from the cash value of his life insurance policy. He is able to take distributions of $267,500 each year, from age 70 until his death at age 85.

Permanent life insurance to the rescue

If the buy-sell agreement had been funded with term insurance, as is so often the case, how would Zack and Alex have survived, when the business sold at a price far less than they had anticipated? The permanent policy's cash value, combined with the Long-Term Care Services℠ Rider, enabled them to live as comfortably as possible after the business was sold.

Alex — $3,000,000 retirement buy-sell plan

Age	Premiums	Cash surrender value	Death benefit	Maximum LTC benefit	Economic benefit of Nathan's policy	Economic benefit of Alex's policy	Economic benefit of Zack's policy
40	$51,282	$0		$3,000,000	$3,000,000	$1,273	$926
45	$51,282	$188,137		$3,000,000	$3,000,000	$1,448	$1,091
50	$51,282	$528,718		$3,000,000	$3,000,000	$1,711	$1,314
60	$51,282	$1,735,950		$4,417,992	$4,417,992	$0	$3,572
65	$51,282	$2,381,463		$5,163,011	$5,163,011	$0	$0
70	$0	$2,973,824	$256,359	$5,540,234	$5,540,234	$0	$0
80	$0	$1,856,435	$256,359	$3,587,916	$3,587,916	$0	$0
100	$0	$733,388	$0	$1,030,171	$1,030,171	$0	$0

Alex takes distributions of $256,359 for 15 years from his policy to supplement his retirement income.

Nathan dies at age 60.

Zack and Alex sell the business.[1]

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A flexible approach to business succession planning

Their retirement buy-sell arrangement gave the Brightens the flexibility they needed to deal with the unpredictable twists and turns of life:

- No one could have predicted that Nathan would die young — but he did. The death benefit from his policy protected his family and allowed the co-owners to continue the business for another decade.
- But, like so often happens, the remaining owners could not maintain the business's growth. Eventually Zack's declining health caused the remaining owners to sell the business.
- The policies that Zack and Alex owned on their own lives enabled them to meet the financial obligations of their post-working years.
- Zack was able to protect himself and his family by utilizing the Long-Term Care Services℠ Rider on his life policy.
- Alex was able to maintain his standard of living in retirement by accessing his policy's cash surrender value.

Is a retirement buy-sell right for your clients and their co-owners?

As you know, for clients who are business owners, it's nearly impossible to separate business succession planning from estate planning. That's because the continuation of their business and the financial security of their families are tied together, and often depend on the structure and funding of their succession plan.

Many times, the business succession plan is a buy-sell arrangement, funded with only term insurance. Unfortunately, term insurance fails to provide the funding necessary for common events that cause the termination of the insureds' business, like a downturn in the economy, disability or health challenge of an owner, or retirement. The retirement buy-sell strategy allows them to purchase a single permanent life insurance contract that not only funds their buy-sell obligation at the death of an owner, but provides them with the cash value to fund a lifetime buy-out of the business or provide supplement income in retirement.

An easy way to explain this concept to your clients

Ask for our retirement buy-sell concept flyer — a client-approved piece that illustrates this concept in easy-to-understand language. It may be just what you need to show your clients what they need to do to plan for their business and the rest of their lives.

For more information, please call the Advanced Markets team.

The Long-Term Care Services℠ Rider is available for an additional cost, and does have restrictions and limitations. Be sure to review the product specifications for further details.

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