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Business Planning Sales Kit



Business Planning



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EMPLOYEES
HELP LEAD YOUR
COMPANY AND
KEEP IT ON THE
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Extra benefits - like life insurance -
show your key employees that you value their
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You carry insurance
coverage to protect
yourself from the loss of
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but what about your most
valuable asset:
your key employees?



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OF FAMILY
BUSINESSES
FAIL OR ARE
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TAKES OVER.


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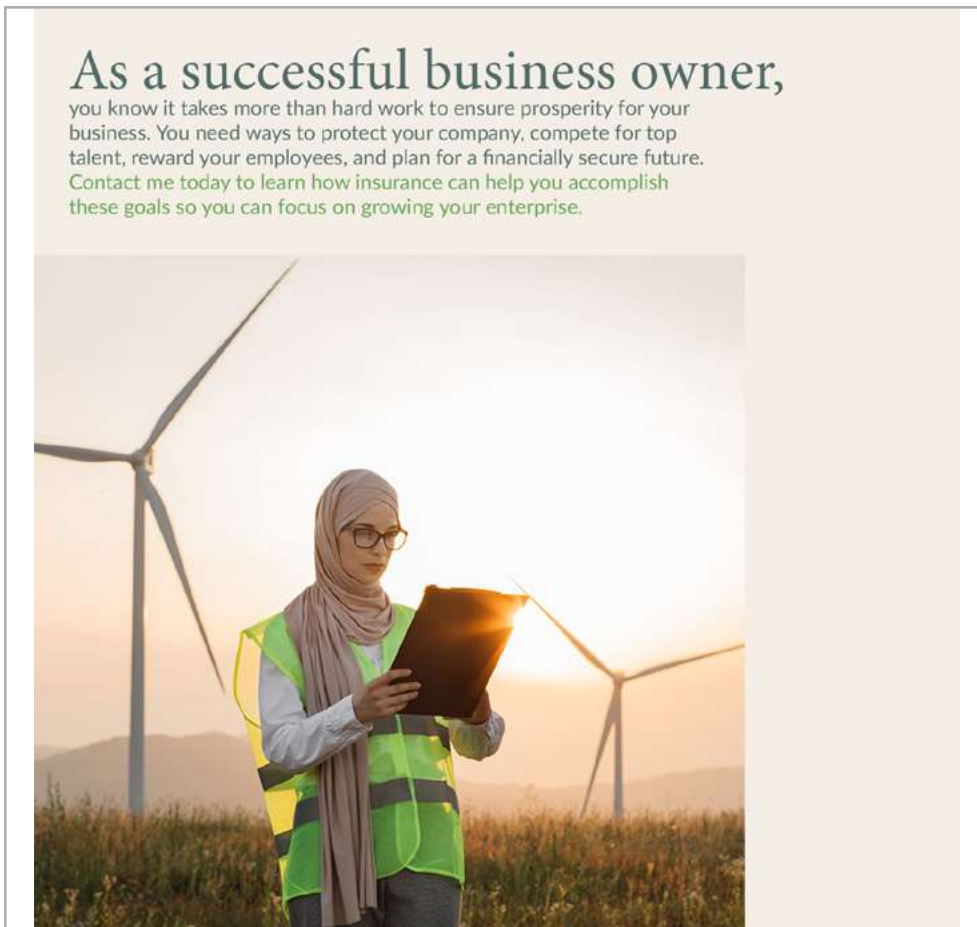
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FIELD GUIDE TO BUSINESS PLANNING
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THE IMPORTANT ROLE OF LIFE INSURANCE IN BUSINESS PLANNING

Transamerica is pleased to provide a consolidated reference guide on the role life insurance can play in your business. This guide is designed to give you actionable concepts and strategies to implement within your organization.

Many entrepreneurs and business owners may not understand how life insurance can play a critical role in their business's success during all stages of life. The reality is any business — no matter the size, structure, or length of establishment — may benefit from one or more of the strategies and concepts contained within this guide. A basic understanding of where life insurance can be leveraged in business planning may help you take care of the current and long-term sustainability of your business, as well as help potentially reduce taxes and be aware of common business planning pitfalls.

You are receiving a copy of this guide because your financial professional recognizes the importance of life insurance in business planning. We hope you find it a useful reference tool in helping you identify potential business planning issues and possible solutions.



Please note the information contained in the guide is not intended to constitute tax or legal advice. Always consult with your tax and legal professionals regarding your personal circumstances.

INTRODUCTION TO BUSINESS ENTITIES

The type of business entity you have established will determine what legal and tax implications will affect your business planning. The structure of your business is important because it will determine how the business operates, what liability the owner or owners have, how the business is taxed, and how expenses, benefits, and compensation are treated. To determine appropriate life insurance coverage amounts, premium dollars, and taxation when implementing these concepts and strategies, it is important to look at your business's financial statements.

SOLE PROPRIETORSHIPS



WHAT IT IS

A sole proprietorship is a business without a separate legal existence from its single owner.

The owner and the business are one and the same legal and tax-paying entity. Business property and assets are personal assets and property of the owner and all debts and liabilities are personal liabilities and debts of the owner. Sole proprietorships are the most common type of business, likely due to the simplicity of formation and the default classification for business with one owner. Many farms, stores, and professional practices adopt this type of business structure.

TAXATION

Since the sole proprietorship isn't a separate tax entity, it neither has to pay tax nor report tax. Therefore, it is not required to file a tax return. Instead, all tax reporting is filed by the owner on their personal tax return. The owner will report any profits or losses on Schedule C and file with Form 1040. All profits or losses are taxed at the owner's individual tax rate. A possible opportunity for a [199A \(Qualified Business Income\) Deduction](#) is described later in this guide.

BUSINESS LIQUIDATION AFTER OWNER'S DEATH

Liquidation (worst case, no will): Once the proprietor passes away, the business assets and liabilities are part of the deceased's estate. Without a properly drafted will, the personal representative or executor may have no other option than to quickly sell the business assets to pay taxes, debts, or other expenses to settle the proprietor's estate. This could ultimately cost the beneficiaries if the assets are sold at lower than valued liquidation prices, and impact the income being produced by the business.

Continuing until a sale of the business can be executed (with a will): If the proprietor has a will, it can give broad authority to the executor to operate the business beyond a normal time needed for liquidation. This may not solve all the problems. The executor may not have the time or experience to run the day-to-day operations of the business. There may not be enough liquidity in the estate to pay the taxes and estate costs, which would force the sale of the business and assets.

BUSINESS LIFE AFTER OWNER'S DEATH

Keeping the business in the family: If the business has been established for years, there may be a family member who has the experience or desire to take over the ownership and management of the business. With a properly drafted will, the proprietor can simply bequeath the business assets to a family member.

Sale to an employee (using a buy-sell agreement): There may not be a family member who is able or willing to take over the business if the proprietor passes away. However, there may be an employee interested in taking over the business. A properly implemented buy-sell agreement can guarantee the orderly transfer of ownership. [Buy-sell agreements](#) are discussed in more detail later in this guide.

PARTNERSHIPS

WHAT IT IS

Under the Uniform Partnership Act (UPA), a partnership is “an association of two or more persons to carry on as co-owners of a business for profit”.

Co-ownership and sharing of profits are the two key elements required to make a partnership. A partnership agreement can be entered into orally, but to avoid any misunderstanding, the partners should have a written partnership agreement. Every state, except Louisiana, models its partnership statute after the UPA or Revised Uniform Partnership Act. The UPA was enacted to help states govern the relationships between the partners as well as the relationships of the partners to third parties. The state statutes will be the default treatment for any partnership matters not specifically addressed in the partnership agreement.



TWO TYPES OF PARTNERSHIPS

General Partnership

All owners are general partners sharing in profits, losses, share in management, and subject to unlimited personal liability for the partnership. There are no limited partners in a general partnership.

Limited Partnership

A limited partnership has at least one general partner and at least one limited partner. Limited partners can contribute capital and share in profits, but are limited to liability for the partnership only up to the amount of their capital investment.



TAXATION

Similar to a sole proprietor, a partnership does not pay income tax. Dissimilar to a sole proprietor, a partnership is a separate tax entity from the partners and is required to file a tax return annually. Form 1065, “U.S. Return of Partnership Income,” is completed by the partnership as an informational return. This form documents any deductions, income, and credits that are separate from the general income and deductions. Schedule K of Form 1065 is used to document the distributive shares, if any, of each of these separate items. Partners report items of profits, losses, deductions, and credits on Schedule E of their Form 1040. A possible opportunity for a [199A \(Qualified Business Income\) Deduction](#) is described later in this guide.

BUSINESS LIFE AFTER PARTNER'S DEATH

Typically, the death of a general partner will dissolve the partnership agreement, while the death of a limited partner does not. Check state statutory law if it is not clearly written in the partnership agreement. When a general partner dies, the partnership is changed, causing dissolution and winding up of the partnership. Unless otherwise written in the partnership agreement, the surviving partners have two choices: liquidation (termination) or reorganization.

Liquidation (termination)

When a partner dies, that partner's share of the partnership passes to the intended beneficiaries. The heirs may need cash from the liquidation of the partnership to settle the deceased partner's estate, or they may not want or be able to take over the deceased's role in the business. This may cause a less than ideal liquidation sale at bargain prices.

Reorganization

With proper planning, a reorganization may prevent a liquidation of the partnership. There are typically four possible options between the deceased partner's heirs and the surviving partners:

- Heirs become partners
- Sell heir's interest to a third party
- Surviving partners sell their interest to the deceased partner's heirs
- The surviving partners buy the deceased partner's share from the heirs

A properly implemented buy-sell agreement between all the partners may provide for the orderly transfer of the deceased partner's share in the partnership and allow the partnership to continue. [Buy-sell agreements](#) are discussed in more detail later in this guide.



WHAT IT IS

An FLP is a business entity that serves a dual purpose as a financial planning tool. It can combine business succession planning, estate planning, tax planning, and business operational planning under one arrangement.

It is used most commonly when an individual owns real estate, a business, or a farm and wants to centralize management while reducing potential estate transfer tax to family members in the future.

Similar to a limited partnership, the FLP has general partners and limited partners. General partners have control over day-to-day operations of the business and have unlimited personal liability for the debts of the partnership, as well as personal liability for the negligence of the other partners. Limited partners are not involved in the operation of the business and their personal assets are shielded from partnership creditors. Limited partners' liability is limited to the amount of personal investment or shares in the partnership.

FAMILY LIMITED PARTNERSHIP (FLP)

HOW AN FLP WORKS - CASE STUDY

Jane and John are in their mid-40s and own some rental properties. Jane and John will be the general partners in the FLP. They have two children in their 20s (Jesse and Janice), who will be the limited partners in their FLP.

Jane and John reserve the name that the partnership will do business under with the Secretary of State's office and file an application for a federal tax identification number (IRS Form SS-4). Then, Jane and John work with an experienced attorney, familiar with partnership agreements in their state, to prepare the partnership agreement, articles, and certificate of limited partnership. Those documents are then filed with the Secretary of State's office. Once the limited partners have signed the acceptance, Jane and John make a capital contribution of their rental properties, currently valued at **\$1,500,000**. The FLP is structured into units worth **\$15,000** each, or 100 total units. Two of the units are general partnership units, and the rest are limited partnership units.

The FLP has now been established and funded with the rental properties. Jane and John may begin a gifting program giving the limited partnership units to Jesse and Janice. The IRS allows FLP units a valuation discount for minority interest and lack of marketability, we will assume the discount is 50%. This reduces the gift tax value of each unit in the FLP to **\$7,500** instead of the **\$15,000** fair market value. IRC Section 2513 allows a married couple to use gift-splitting, so Jane and John can gift a combined **\$30,000** to each child each year by utilizing the full gift tax exclusion. This means Jane and John can gift each child four limited partnership units each year, or eight units per year to their two adult children.

This assumption implies the value of the units will stay the same or increase in the same proportion as indexed increases in the gift tax annual exclusion. In this case study, all 98 units of the limited partnerships units will be completely transferred to the two adult children in 12 years without utilizing any of Jane and John's lifetime gift tax exemption amount.

NEED FOR LIFE INSURANCE IN FLPs

FLPs can be the owner of a life insurance policy, which can help create liquidity for an owner's estate upon their passing. You should consult your tax and/or legal professional before establishing these policies.

Further, there is a business insurance need for FLPs, just like any business entity. Business insurance needs include, but are not limited to:

- Key person life insurance
- Executive benefit strategies
- Business succession planning such as funding a buy-sell agreement among the partners

CORPORATIONS

WHAT THEY ARE

A corporation is created under state law and cannot legally exist without authorization from the state government.

Most states have a registration process to apply for incorporation. The steps set forth in the state corporation statutes must be completed before a corporation can begin doing business. Once a corporation is established, the shareholders purchase shares of equity in the corporation, which gives them the right to vote, elect the board of directors, attend shareholder meetings, receive dividends, inspect the books, and transfer shares freely unless restricted. After the shareholders elect the board of directors, it is their responsibility to appoint officers who will carry out the day-to-day management of the corporation.



HOW TO FORM A CORPORATION



First, an individual, called the incorporator, will work with an attorney familiar with that state's corporate statutes to draft a certificate of incorporation. The articles of incorporation will typically include:

1. The name of the corporation
2. The county where the principal office of the business will be located
3. The purpose for the formation of the corporation, which is typically to conduct any and all lawful business
4. The names and addresses of the incorporators and initial directors
5. Identify the number of shares of each share class that the corporation can issue and the par value, if any, of the shares
6. Identify how long the corporation will stay in existence, typically indefinitely

Once the articles of incorporation are drafted by the attorney and signed by the incorporators, they will file them with the state agency charged with accepting corporate registrations. It could be the Secretary of State's office, but it may be a different agency. Unless a later date is requested, the corporation becomes effective when the articles are properly filed. At this point, the incorporators must take a few additional steps before the corporation becomes a functioning business:

- A meeting of the shareholders will be called to elect the board of directors of the corporation
- The board of directors will typically use the meeting to elect officers and adopt the corporation's bylaws
- The corporation will then need to obtain all necessary licenses and registrations to conduct the particular type of business it was created for. These may include state tax registration, specific occupational licenses, and municipal business licenses.



C CORPORATION



WHAT IT IS

A C corporation is an incorporated business that has chosen to be taxed for federal income tax purposes as a separate entity from its shareholders.

The shareholders are not liable for the debts and liabilities incurred by the corporation. The shareholder's liability is limited to the amount of capital investment in the corporation.

TAXATION

A C corporation is taxed at a different rate than individuals. In 2021, C corporations pay a flat 21% on taxable income. A corporation will determine its taxable income by subtracting the allowable deductions from gross income. Whether or not the corporation has income for a year, or owes tax, it must file a return annually using IRS Form 1120, "U.S. Corporation Income Tax Return."

DIVIDENDS AND SALARIES

C corporations are sometimes thought of as having certain earnings that are taxed twice. For example, dividends are taxed to the corporation when the income is earned and again to the shareholder when paid out. Dividends are not tax deductible to the corporation the way paid salaries are. This is why many refer to dividends from a corporation as being "double-taxed." Salaries, on the other hand, are deductible to the corporation as long as they are a reasonable amount. A corporation may decide to retain a certain level of earnings instead of paying them out as dividends or salaries.

ACCUMULATED EARNINGS TAX

If a corporation allows its earnings or profits to accumulate over a reasonable amount instead of paying out to the shareholders as dividends, they will be assessed a 20% accumulated earnings tax. If earnings are retained over **\$150,000** for service corporations, or **\$250,000** for business corporations, the accumulated earnings tax may apply if there is not a reasonable business purpose. This can be viewed as a penalty tax that is meant to encourage dividend distributions of unnecessary accumulations to the shareholders. One reasonable business purpose for accumulation over these thresholds is to fund 303 stock redemptions.

TAX ADVANTAGES OF C CORPORATIONS

1. Earnings can be accumulated for business purposes without current taxation to shareholders.
2. Reasonable salaries and bonuses for shareholder employees are deductible.
3. Tax favored employee benefits, such as health insurance and group life insurance, can be provided to shareholder employees.



SUBCHAPTER S CORPORATION



WHAT IT IS

An S corporation is an incorporated entity that elects to be taxed under subchapter S of the Internal Revenue Code. Instead of paying corporate tax rates, it has similar tax characteristics to a partnership.

Both partnerships and S corporations pass through profits and losses to shareholders, who in turn pay taxes on their respective shares of the corporation's income at their individual income tax rates, even if the income is not distributed. An S corporation must meet several requirements, including:

- It must be domiciled in the U.S.
- It must have 100 or fewer shareholders. Lineal descendants of the same family can all be treated as one shareholder.
- None of the shareholders can be nonresident aliens
- All shareholders must be individuals, estates, certain trusts, qualified retirement plans, and/or 501(a) charitable organizations
- It can only issue one class of stock

TAXATION

Even though the S corporation passes the tax liabilities through to the shareholders, it must file an annual tax return on IRS Form 1120-S, "U.S. Income Tax Return for an S Corporation." A possible opportunity for a [199A \(Qualified Business Income\) Deduction](#) is described later in this guide.

TAX ADVANTAGES OF S CORPORATIONS

Avoids double
taxation of dividends

Avoids the possibility
for accumulated
earnings tax

Net operating losses
can reduce personal
gross income

Possibility for 199A
deduction of up to
20%

LIMITED LIABILITY COMPANY (LLC)

WHAT IT IS

An LLC is a hybrid entity that can join the limited liability of a corporation with the pass-through tax advantages of a partnership. LLCs are a relatively new form of entity and are the fastest growing form of business.

LLCs are authorized in all states and are the most flexible form of business entity. An LLC is formed through articles of organization being filed with the state. They typically include:

- The name of the LLC
- The nature of the LLC’s business
- The name and address of the members and managers
- Whether it will be member-managed or manager-managed:
 - Member-managed LLCs usually have less members and those members are willing to be involved with day-to-day operations of the business
 - Manager-managed LLCs usually have a relatively large number of members and those members aren’t willing to be involved with day-to-day operations of the business
- The name and address of the registered agent
- The principal office address
- An operating agreement is a legal document that outlines the ownership structure and member roles; not all states require this, but it is a good idea to have one

ADVANTAGES OF LLCs

All members have limited liability

Flexibility in operating and management structure

Asset protection from creditors in some states

No restrictions on members, like those of an S corporation

Tax treatment elected is typically pass-through allowing owners to be eligible for a 199A deduction

Some flexibility may allow allocating certain amounts of income or losses to individual members

TAXATION

For federal tax purposes, a multimember LLC is taxed as a partnership and a single-member LLC is taxed as a sole proprietorship, unless otherwise elected. An LLC can participate in the “check the box regulations” indicating it would like to be taxed as a corporation by filing IRS Form 8832, “Entity Classification Election.” Furthermore, it may elect to be taxed as an S corporation, as long as the ownership restrictions are met, by filing IRS Form 2553, “Election by a Small Business Corporation.” Even though the corporate taxation option is available for LLCs, they often elect to be taxed as partnerships. If the LLC is taxed as a sole proprietorship or partnership, there is a possible opportunity for a [199A \(Qualified Business Income\) Deduction](#). See the description on the next page.





IRC 199A – Qualified Business Income (QBI)

The Tax Cuts and Jobs Act of 2017 created a deduction for many owners of pass-through businesses, including some sole proprietorships. Owners can claim up to a **20%** deduction — although gradually phased out — when their taxable income is under a threshold amount (in 2021, \$329,800 for married filing jointly, \$164,925 for married filing separately, and \$164,900 for all others). Generally, the deduction is not available to business owners in specified service trades or businesses (high-earning doctors, lawyers, accountants, etc.), and has a number of other restrictions and exceptions. Business owners should discuss this possible deduction with a tax professional.

TAXABLE INCOME THRESHOLDS	QUALIFIED TRADE OR BUSINESS (QTB)	SPECIFIED SERVICE TRADE OR BUSINESS (SSTB)
Single: \$0 – \$164,900 Married Filing Jointly: \$0 – \$329,800	20% QBI deduction — up to 20% of taxable income	20% QBI deduction — up to 20% of taxable income
Single: \$164,901 – \$214,500 Married Filing Jointly: \$329,801 – \$429,800	Both deduction phase out and wage/capital limitation apply	Subject to deduction phase out
Single: \$214,500 + Married Filing Jointly: \$429,800 +	QBI Deduction is lesser of A or B: A: 20% of QBI, or B: The greater of: <ul style="list-style-type: none"> 50% of W-2 wages, or 25% of W-2 wages plus 2.5% of unadjusted basis of depreciable assets 	No deduction

SUMMARY OF BUSINESS ENTITIES

TYPE OF BUSINESS	OWNERSHIP STRUCTURE	LIABILITY	TAXATION
Sole Proprietorship — The simplest form of business; the business doesn't have a separate legal existence from the owner	Unincorporated — Single owner and business are one and the same for legal and tax purposes	Owner has unlimited personal liability	Owner reports profits and losses on Schedule C and files with Form 1040 on his/her individual tax return Potential 199A (Qualified Business Income) deduction of 20% depending on the specified trade or business and income phase out limits
Partnership — Two or more owners (partners) who contribute to all aspects of the business and share in the profits and losses	Unincorporated — Two or more persons or entities	General partner has unlimited personal liability. Limited partner has liability to the total amount of investment in the partnership	Partnership files a tax return. Form 1065 - U.S. Return of Partnership Income is used to show the total distributive share of each deduction, income, and credit on Schedule K. Then, Schedule K-1, Partner's Share of Income, Deductions, Credits, etc., is used to enter each partner's share of each item (which is dependent on the terms of the partnership agreement) and is used for each partner in filing their individual tax return. Partners report profits, losses, deductions, and credits on Schedule E of their Form 1040 Pass-through profits and losses. Potential 199A (Qualified Business Income) deduction of 20% depending on the specified trade or business and income phase out limits
C Corporation — A legally independent entity owned by shareholders	Incorporated — One or more persons or entities	Full asset protection. Owners/shareholders have no personal liability	A C corporation must file a tax return annually, even if it doesn't owe any tax or have any income. Income is reported on Form 1120 Dividends Double Taxation of Dividends: Corporation is taxed on profits at the entity level. Shareholders are taxed again on dividend distributions on Form 1099-DIV. Dividends paid to shareholders are not deductible by the corporation Compensation C corporations can deduct a reasonable amount for salaries paid to officers and employees Accumulated Earnings Tax Possible additional income tax for unreasonable amounts of earnings or profits not being distributed to shareholders
S Corporation — A legally independent entity owned by shareholders	Incorporated — One or more (up to 100) U.S. citizen persons, estates, certain types of trusts, charitable organizations, and qualified retirement plans	Full asset protection. Owners/shareholders have no personal liability	Subchapter S corporations elect not to pay any corporate tax on their income. Instead, shareholders pay taxes on their respective shares of corporate income at their individual income tax rates, even if/when income from the S corporation is not distributed to them. Even though it does not pay tax, the S corporation must file an annual tax return on Form 1120-S. Pass-through profits and losses. Potential 199A (Qualified Business Income) deduction of 20% depending on the specified trade or business and income phase out limits
Limited Liability Company (LLC) — A hybrid entity that joins the limited liability of a corporation with the pass-through tax advantages of a partnership	Unincorporated — One or more persons or entities	Owner(s) have no personal liability	Depends how the LLC is filed. An LLC can choose its federal tax classification as a Partnership (if two or more members), S corporation, C corporation, or Sole Proprietor (if single member). This election is made on Form 8832, Entity Classification Election. If established as a pass through for profits and losses, there is a potential 199A (Qualified Business Income) deduction of 20% depending on the specified trade or business and income phase out limits
Family Limited Partnership — A unique limited partnership structure	Two or more family members or trusts for the primary benefit of family members (typically of different generations)	General partner has unlimited personal liability (usually older family member). Limited partner has no personal liability. Only liable to the total amount of investment in the partnership (usually second/third generation family member)	Same as Partnerships

BUSINESS-OWNED LIFE INSURANCE

(ALSO KNOWN AS EMPLOYER-OWNED LIFE INSURANCE (EOLI) OR COMPANY OR CORPORATE-OWNED LIFE INSURANCE (COLI))

Many business entities own life insurance to protect the business. From attracting and retaining key employees and top talent to safeguarding the business from potential negative financial impacts due to an unexpected death, there are several important reasons why a business may want to own life insurance on an employee, or past employee. Regardless of the business need for life insurance, there are requirements that need to be met for disclosure, consent, and reporting. Failure to abide by these requirements can result in death benefit proceeds being taxable to the employer.

EMPLOYER-OWNED LIFE INSURANCE

WHAT IT IS

A life insurance policy on an employee that is owned by the business and the business is also the beneficiary is called employer-owned life insurance. It is also commonly referred to as corporate or company-owned life insurance. The terms are interchangeable.

The Internal Revenue Code defines an EOLI contract as:

1. A policy owned by a person engaged in a trade or business under which that person or a related person¹ is directly or indirectly a beneficiary of the policy²; and
2. The policy insures an employee in the trade or business of the policy owner or a related person on the date the contract is issued.³

¹ A "related person" is a person who bears a certain relationship to the policy owner, or is engaged in trades or business with persons under common control with the policy owner – anyone related to the policyholder under the family or entity attribution rules of sec. 267(b) and sec. 707(b)(1). Sec. 101(j)(3)(B).

² IRC § 101(j)(3)(A)(i)

³ IRC § 101(j)(3)(A)(ii)



TAXATION OF DEATH BENEFITS TO THE BUSINESS

When a business receives the death benefit from an EOLI policy, the IRS allows them to exclude from income the amount of premiums and amounts paid into the policy.⁴ The remaining amount of the death benefit received is reported as income to the business. This is effective for contracts issued after August 17, 2006. However, there are some exceptions to this IRS inclusion rule, which could allow the entire death benefit proceeds to be free of income tax to the business, once the business satisfies the notice and consent requirements, and any one of the following:

1. Exception for a recent employee: The insured was an employee of the employer at any time during the 12-month period before the insured's death.⁵
2. Exception for a director or highly compensated employee or individual at the time the policy was issued. This would include:⁶
 - A director
 - A 5%-or-greater owner of the business at any time during the current year or the preceding year
 - A highly compensated employee or highly compensated individual with compensation of at least \$130,000 for 2021 (adjusted annually for cost-of-living)
 - One of the five highest-paid officers
 - Among the highest-paid 35% of all employees
3. Exception for death proceeds paid to heirs: The death proceeds are paid to:⁷
 - A member of the insured's family, which includes brothers and sisters (also half-brothers and half-sisters), spouse, ancestors, and lineal descendants
 - Any individual who is the designated beneficiary of the insured under the contract (other than the employer)
 - A trust established for any family member or designated beneficiary, as just described
 - The estate of the insured
4. Exception for death benefit proceeds being used to purchase an equity interest in the business (employer) by any family member, beneficiary, trust, or estate.⁸ This exception does have a deadline of the employer's tax return filing for the year in which the death benefit was received by the heirs in order to be used to purchase the equity interest in the business.

⁴ IRC §101(j)(1)

⁵ IRC §101(j)(2)(A)(i)

⁶ IRC §101(j)(2)(A)(ii)

Planning point

Note that if the second exception is satisfied, the highly compensated employee would not need to be a current, or recent, employee of the business.



NOTICE AND CONSENT

The requirement for notice and consent is an important element for the business to be able to use any exception and avoid the income inclusion of the death benefit proceeds. There are three components to the notice and consent requirement that must be met before the policy is issued:

1. Notify the employee in writing that the employer intends to insure the employee's life. The notice must state the maximum face amount for which the employee could be insured at the time the policy is issued. The face amount must be either in dollars or as a multiple of salary.
2. Obtain the employee's written consent to being insured under the policy (including the possible continuance of the insurance after the insured terminates employment).
3. Inform the employee in writing that the employer will be directly or indirectly a beneficiary of any proceeds payable on the employee's death.

An inadvertent failure to satisfy the notice and consent requirements may be corrected under the following circumstances:⁹

1. The applicable policyholder (business/employer) made a good faith effort to satisfy those requirements, such as maintaining a formal system for providing notice and securing consents from new employees.
2. The failure was inadvertent.
3. The failure was discovered and corrected no later than the due date of the tax return for the taxable year of the applicable policyholder (business/employer) in which the policy was issued. Because IRC §101(j)(4)(B) requires that the employee's consent be written, failure to obtain consent cannot be corrected after the insured employee has died.

A sample notice of consent is on the next page.

⁷ IRC §101(j)(2)(B)(i)

⁸ IRC §101(j)(2)(B)(ii)

⁹ IRS Notice 2009-48, Q-13 & A-13

EMPLOYER INTENT TO INSURE EMPLOYEE'S LIFE

_____ (“Employee”) is being notified by
_____ (“Employer”) under Internal Revenue
Code § 101 (j) that:

- A. Employer intends to apply for insurance on Employee’s life;
- B. The maximum face amount at the time the policy is issued on the life of the Employee shall not exceed \$ _____ ; and
- C. Employer shall be a direct or indirect beneficiary of life insurance proceeds payable upon death of Employee.

EMPLOYEE CONSENT TO BEING INSURED

Employee acknowledges receipt of this notice and agrees to:

- A. Consent to being insured by Employer;
- B. Consent to the policy being continued following any termination of employment with Employer; and
- C. Consent to employer being a direct or indirect beneficiary of any life insurance proceeds payable.

Employee

Date



ANNUAL FILING REQUIREMENTS

Employers that own life insurance on their employees also must comply with the ongoing requirement outlined in IRC § 6039I, which requires an annual report of EOLI contracts. Reporting is accomplished by attaching IRS Form 8925 to the employer's income tax return for the year.

The employer must report the following to the IRS annually:

- The total number of employees under the employer at the end of the tax year
- The number of those employees insured under employer-owned life insurance contracts at the end of the tax year for policies issued after August 17, 2006
- The total amount of insurance in force at the end of the tax year under those contracts
- The name, address, and taxpayer identification number of the employer, and the type of business in which the employer is engaged
- Verification that the employer has a valid consent for each insured employee, or, if all required consents are not obtained, the number of insured employees for whom consent was not obtained

Employers are required to keep records that show the requirements of both IRC § 101(j) and 6039I are met for all applicable tax years by filing IRS Form 8925, "Report of Employer-Owned Life Insurance Contracts."

KEY EMPLOYEE LIFE INSURANCE



WHAT IS KEY EMPLOYEE LIFE INSURANCE?

Essentially, all businesses rely on employees for the success of the business. Some employees may provide a more critical role to contributing to the ongoing financial success of the business than others. The loss of one of these key employees could be detrimental to the business's continuation. To help protect against the loss of a key employee's contributions and expertise, a business can purchase insurance on the key employee's life.

This can be a form of EOLI and subject to the IRC § 101(j) guidelines. The employer retains all incidents of ownership, pays the premiums, and receives the death benefit proceeds as the beneficiary. The premiums are not tax deductible to the employer, but as long as IRS guidelines are met, the death benefit proceeds are received free of income tax. The strategy, not type of insurance policy, is a way for a business to hedge against the premature loss of a key employee. The negative impact of the unexpected death of a key employee can be offset by the death benefit proceeds provided by the life insurance policy. This allows the business to economically stay afloat and successfully transition from the loss until a replacement is found.

WHO MAY BE CONSIDERED A KEY EMPLOYEE?

A key employee could be viewed as anyone who provides for the ongoing financial success of the business in a critical way. Characteristics that could be used to identify key employees are:

- Employees with a specialized skill set or knowledge base that is critical for the success of the business; having to find a replacement may be time consuming to recruit and train and will typically require a higher salary level than non-key employees
- Employees in a sales capacity who have a large customer base and a high impact on generating sales for the business
- Employees who may be a source of capital and whose loss would damage the credit worthiness of the business

The purpose of key employee insurance is to help the business protect itself from the potential economic loss that could occur when a key employee passes away.

If proper planning is not completed, a business will typically see adverse consequences from losing a key employee:

1. A loss or interruption of leadership from losing an experienced manager of the business
2. A loss or interruption of sales generated from losing a talented sales employee
3. A loss in business may impact the ability to make credit payments, or obtain new lines of credit
4. Time and expense to recruit and train a new key employee
5. A loss of competitive position or goodwill in the marketplace
6. A loss or interruption of production or operations

The impact of these losses is more extreme for smaller businesses that rely on the contributions of a few critical employees. Identifying the key employees might not be as straightforward as one would think. The owner, officers, and directors could be considered key employees, but the important role of managerial employees is sometimes overlooked. To help identify possible key employees, consider the impact of having a top-tier sales member or manager missing a considerable amount of time at work.

ADVANTAGES OF KEY EMPLOYEE LIFE INSURANCE

Key employee life insurance helps a business plan for and protect against the uncertainty of losing a critical member of the team. Two major advantages of implementing key employee life insurance are:

1.

If the key employee dies, the employer receives the policy's death benefit to help meet the financial needs of the business and help carry the business through the gap of recruiting and training a new key employee.

Further, if the employer provided the notice and consent requirements under IRC § 101(j) guidelines as discussed in the EOLI section, the death benefit proceeds are received free of income tax.

2.

If cash value life insurance is used to fund the key employee policy, the business can access the cash value, through loans and withdrawals*, while the employee is still alive.

The employer should understand the impact withdrawals and loans will have on death benefits and taxation before accessing cash values.

HOW KEY EMPLOYEE INSURANCE WORKS

The employer/business must:

- Give notice and receive consent to obtain the life insurance on the key employee per IRC § 101(j) guidelines
- Receive proper approval necessary to purchase the life insurance on the key employee. This will vary by type of business structure. For example, a corporation will need the board of directors to adopt a resolution permitting the purchase of the key employee policy.
- Apply for, own, and be the beneficiary of the insurance policy on the key employee's life. If the business does not retain complete ownership and the insured has any incidents of ownership, the death benefit proceeds will be included in the insured employee's estate for federal estate tax purposes.
- Pay all the premiums and abide by the reporting and recordkeeping requirements for EOLI policies
- Receive the death benefit proceeds at the employee's death

The employer identifies a key employee whose death would result in financial loss to the business.

The business gives notice that it intends to insure the employee's life and obtains the employee's written consent.

Employee



Employer

The employer applies for, owns and is the beneficiary of insurance on the employee's life. The employer pays the premiums on the policy. **Premium payments are not tax deductible.**

If the employee dies, policy proceeds are paid to the employer to compensate the economic loss suffered as a result of the key person's death.



TRANSAMERICA®

* Loans, withdrawals, and death benefit accelerations will reduce the policy value and death benefit and may increase the chance of the policy lapsing. Provided the policy is not and does not become a modified endowment contract (MEC), 1) withdrawals are tax-free to the extent that they do not exceed the policy basis (generally, premiums paid less withdrawals) and 2) policy loans are tax free as long as the policy remains in force. If the policy is surrendered or lapses, the amount of the policy loan will be considered a distribution from the policy and will be taxable to the extent that such loan plus other distributions at that time exceed the policy basis.



KEY EMPLOYEE VALUATION

Determining the value a key employee brings to your business may be the most difficult step in establishing a key employee life insurance strategy. The valuation may vary depending on the characteristics of the employee and the type of valuation method used. Many different techniques can be used to determine the value of the key employee. There are calculators available to assist in finding the right number. It can be as simple as a multiple of salary, or as complex as mathematical forecasting using several factors. Regardless of the method used, the value should not exceed a reasonable value of the key employee and should not be forecasted indefinitely. In this guide, we will discuss two: the contribution to profits method and the excess salary method.

Contribution to Profits Method

A business can take the following steps to determine a key employee's value using the contribution to profits method:

1. Establish the annual profits generated by the key employee
2. Multiply the annual profits that would be lost by the remaining estimated years until retirement
3. Multiply that number by the present value factor for \$1 per year, using a reasonable rate of interest to discount future earnings

Case Study

Denise has been a salesperson for Pharmaceutical Manufacturers of America (PMA) for most of her career and is 10 years away from retirement. PMA estimates her loss would cause an average annual loss in profits of **\$250,000**. This would equate to **\$2,500,000** over her remaining 10 years of employment before retirement. PMA then discounts the **\$2,500,000** using a 7% interest rate, which equates to **\$1,750,000**. PMA will provide Denise with the proper notice and consent and apply for a **\$1,750,000** face amount life insurance policy. If Denise dies, PMA would not suffer the economic loss from losing one of its top salespeople.

Excess Salary Method

A business can take the following steps to determine a key employee's value using the excess salary method.

1. Establish the difference in salary between the key employee and someone else who would perform the same duties
2. Multiply the difference by the number of years it would take to recruit, train, and grow the expertise the current key employee has

Case Study

Frank has been a manager for PMA the majority of his career and has gained much needed expertise for the ongoing success of the business. His current salary is **\$250,000**, which is more than others in his same position are paid elsewhere. PMA is willing to pay this extra amount to Frank because its success is based largely on Frank's expertise. Someone in a similar position elsewhere would be paid a salary of **\$150,000**. If PMA hires a replacement for Frank, it would take the replacement five years to gain Frank's expertise. The difference in salary equals **\$100,000** multiplied by the number of years to recruit, train, and grow the expertise of five years equals **\$500,000**. PMA will provide Frank the proper notice and consent and apply for a **\$500,000** face amount life insurance policy. If Frank dies, PMA would not suffer the economic loss from losing one of its top managers.

TAX CONSIDERATIONS FOR THE BUSINESS

Premiums

Under IRC § 264 guidelines, when a business is the beneficiary of a key employee life insurance policy, the premiums are not tax deductible. The business will have to determine how much it can afford to pay for premiums on the key employee life insurance policy. Either term or cash value life insurance can be used. Term will offer the appropriate coverage needed for the established time frame at a lower premium amount. While cash value will have a higher premium; it is typically the preferred option because it can provide additional benefits for the business. However, the health of the insured key employee also needs to be taken into consideration. If they are not able to obtain the best health rating for life insurance, the premiums will be higher.

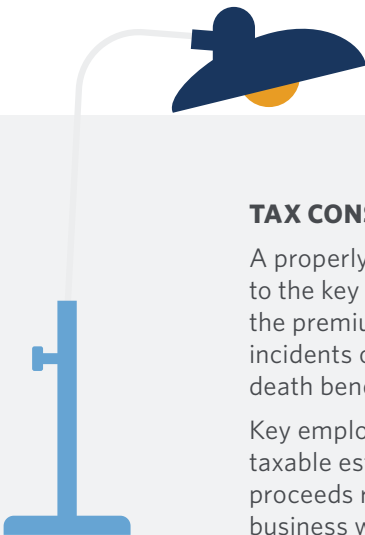


Policy Loans

Similar to premiums, a business cannot deduct the interest paid or accrued on loans from life insurance policies that cover employees, or anyone financially interested in the business. Key employee policies are a limited exception. For purposes of discussing this exception, a key employee is defined as officers and 20% or greater owners of the business. There is a maximum number of key employees this exception will cover. The greater of five people, or the lesser of 5% of total officers or employees, or 20 individuals. This exception allows the business to take a deduction for policy loan interest to the extent that any one policy loan does not exceed \$50,000, and interest paid for a month does not exceed the Moody's Composite Yield on Seasoned Corporate Bonds.

Death Benefit

As discussed in the prior section, EOLI, as long as IRC § 101(j) guidelines are met, the death benefit proceeds received by the business will be free of federal income tax.



TAX CONSIDERATIONS FOR THE KEY EMPLOYEE

A properly implemented key employee insurance arrangement will not result in any taxation to the key employee themselves. The business should hold all incidents of ownership, pay the premiums, and receive the death benefit proceeds. However, if the key employee has any incidents of ownership, such as the right to change the beneficiary or take a policy loan, the death benefit value is included in the key employee's taxable estate.

Key employee insurance covering a partner or controlling shareholder is not included in their taxable estate, but the value of the business will increase by the amount of death benefit proceeds received on their life, which will indirectly reflect in a proportional interest of the business when settling their estate.



EXECUTIVE BENEFITS

EXECUTIVE BONUS ARRANGEMENT

An executive bonus arrangement, also referred to as an IRC §162 arrangement, is a way for businesses to reward certain employees with a bonus to pay for their life insurance policy. The employer pays a bonus, either in cash or premium payments, to select employees under the arrangement on a personal life insurance policy of the employee. These types of arrangements can help businesses attract top talent as an additional benefit of employment to supplement their qualified plan and group term offerings. This is different from key employee life insurance, which protects the business from a premature loss of a key employee.

Once the arrangement is established, the employee applies for a personal permanent life insurance policy. The employee names someone other than the business as beneficiary. The employer will report the cash or premium payment bonus as additional compensation each year on the employee's W-2. Since this bonus is taxable to the employee, it is tax deductible to the business. A business may even offer a "double bonus" by paying a larger bonus to cover the income tax liability to the employee. The business may need to obtain a corporate resolution adopted by the board of directors to implement the arrangement.

Double Bonus Case Study

Enrique is a top executive at Technology Manufacturers of America (TMA) and was offered an executive bonus arrangement that included an additional bonus for his income tax liability. The double bonus includes his applicable ordinary income tax, payroll taxes, state tax, and local tax rates, which equate to 45%. Enrique's permanent life insurance policy premiums are **\$13,750** a year. In order for TMA to determine the extra bonus needed to cover Enrique's tax liability, it would take **\$13,750** annual premium divided by .55 (1 minus .45). The total executive bonus for Enrique each year would equal **\$25,000**. This double bonus will cover the 45% tax Enrique will pay on the **\$13,750** bonus he receives for him to pay his permanent life insurance policy.

Benefits to the Business

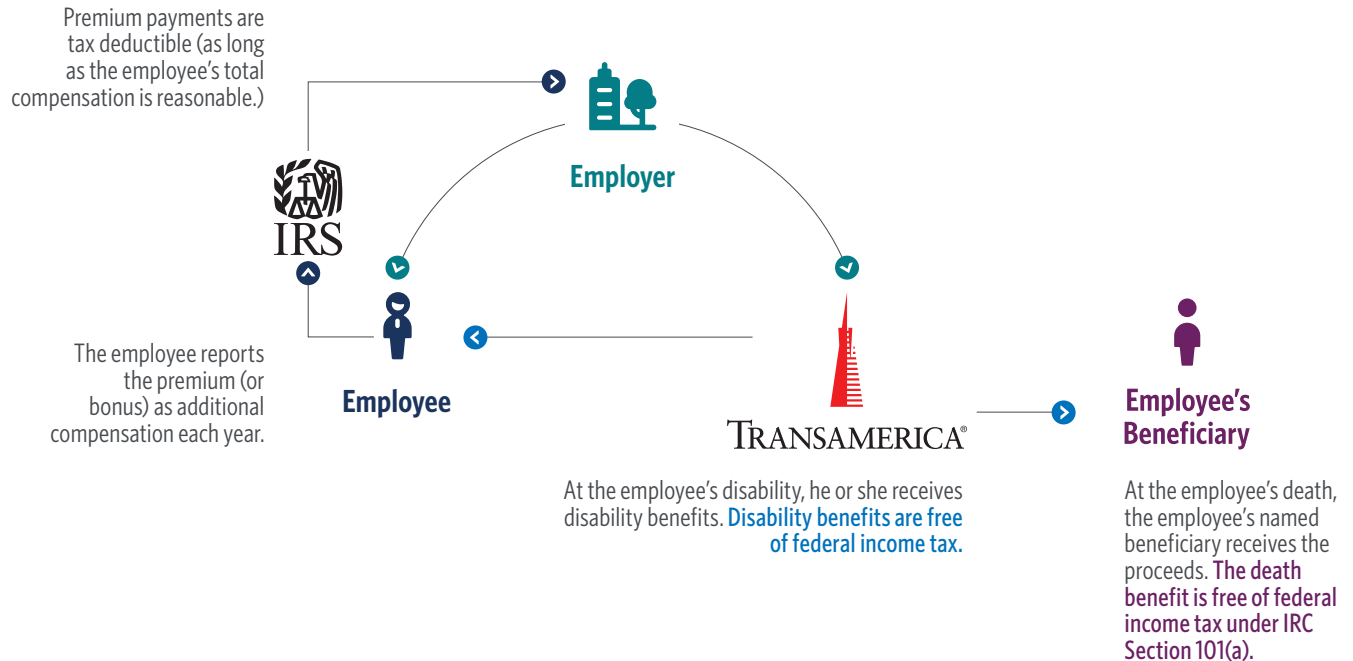
- Bonuses used to pay premiums is an ordinary and necessary business expense to the extent it is reasonable and will be tax deductible to the business under IRC §162
- Because this is an arrangement between the business and the employee, the IRS does not need to preauthorize it or require disclosure and annual reporting
- Because this is not a qualified plan, there are no annual administrative costs to the business and the bonus is handled through normal payroll services
- Because this is not a qualified plan, the business can select the employees to whom they offer this benefit
- Helps the business recruit and maintain top talent in their industry

Benefits to the Employee

- Since the employee is the owner of the life insurance policy assuming premium payments are met, it will stay with them even if they leave the company
- Double bonus arrangements cover the tax liability to the employee
- Since the employee is the owner of the permanent life insurance policy, he or she has access to the cash value and can borrow* from the policy
- The employee chooses the beneficiary, anyone other than the business, who receives the death benefit generally free of income tax

* Loans, withdrawals, and death benefit accelerations will reduce the policy value and death benefit and may increase the chance of the policy lapsing. Provided the policy is not and does not become a modified endowment contract (MEC), 1) withdrawals are tax-free to the extent that they do not exceed the policy basis (generally, premiums paid less withdrawals) and 2) policy loans are tax free as long as the policy remains in force. If the policy is surrendered or lapses, the amount of the policy loan will be considered a distribution from the policy and will be taxable to the extent that such loan plus other distributions at that time exceed the policy basis.

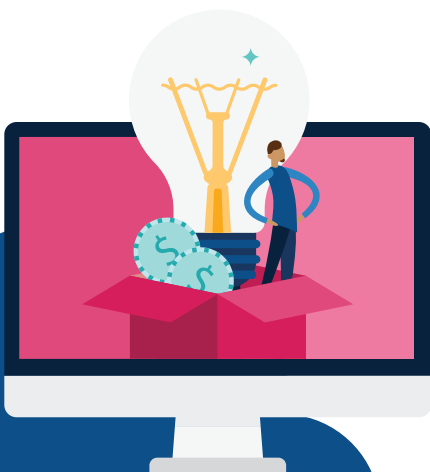
HOW EXECUTIVE BONUS ARRANGEMENT WORK



1. The employer selects the employee(s) it wishes to benefit and pays annual premiums on a life insurance or disability policy, either directly or by way of a cash bonus to the employee. Premium payments are tax deductible to the employer as long as the employee's total compensation is considered reasonable.
2. The employee reports the premium (or bonus) as additional compensation each year.
3. At the employee's death, his or her beneficiary receives the death proceeds free of federal income taxes under IRC Section 101(a).
4. At the employee's disability, he or she receives disability benefits free of federal income tax.

RESTRICTED EXECUTIVE BONUS ARRANGEMENT (REBA)

Some businesses may want to maintain more control over the executive bonus arrangement they enter into with an employee. A REBA establishes some limitations for the employee while they are still employed. The employee still owns the permanent life insurance policy and the business pays the bonus for the premiums. However, the difference is this type of policy contains a special endorsement, which requires the employee to obtain the employer's consent to borrow or withdraw cash value, surrender the policy, collaterally assign the policy for a loan, or change the ownership of the policy. This special endorsement does not give businesses any form of ownership, therefore still allowing them to deduct the bonus. The REBA will usually stipulate when these restrictions will be lifted. It could be upon retirement or disability, at a certain age, or once a waiver and release has been signed by the employer. Typically, the business will enter into a separate agreement with the employee that outlines what would happen if the employee terminates their employment with the business before retirement. It may require the employee to pay back all, or a portion of the bonuses received. Once the restricted period has ended, the business must send a written statement to the life insurance company to lift the special endorsement on the policy.



EXECUTIVE BONUS PLAN FACT FINDER

EMPLOYEE

Name _____

Annual Compensation \$ _____ Federal Tax Rate (Including FICA) _____ State and Local Tax Rates _____

Company Ownership (if any) % _____

EMPLOYER

Name _____

Address _____

Entity Type: ☐ C Corporation ☐ S Corporation ☐ Partnership ☐ LLC

Federal Tax Rate _____ State and Local Tax Rate _____

Total Number of Employees _____

ILLUSTRATION

Product to Illustrate _____

Policy Assumptions: Current _____ Guaranteed _____

Insured's DOB _____ State of Policy Issue _____

Gender: ☐ Male ☐ Female

☐ Smoker ☐ Nonsmoker

Assumed Risk Classification: ☐ Select ☐ Preferred ☐ Standard

Death benefit \$ _____ or minimum so as not to create a MEC _____

Death benefit option: Level _____ Increasing with cash value _____ Increasing switching to level _____

Plus-premium _____

Annual insurance premium \$ _____

Years to pay premium _____ or to age _____

Maximize income from policy at insured's age _____ for _____ number of years _____

If premium is not known, indicate desired cash flow _____

Policy cash value at age 100 equal to: _____

Endowment at initial face _____ or keep in force until age 100 _____ or cash value equal to \$ _____

PLAN DESIGN

Bonus Amount: Single _____ Double _____ Specified \$ _____

Pay Bonus Until: Retirement _____ Specified \$ _____

PRODUCER INFORMATION

Producer Name _____

Phone No. _____

E-mail Address _____

Date _____

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NONQUALIFIED DEFERRED COMPENSATION ARRANGEMENT

Providing additional benefits to owner-employees, key executives, and other skilled and highly compensated employees is something all businesses must address to attract and retain top talent. The increasing regulation of qualified retirement plans and high costs to administer them has made nonqualified deferred compensation arrangements increasingly attractive for businesses and their employees. These arrangements allow the business to identify and select highly compensated employees or independent contractors to participate in creating financial security in retirement, upon death, or disability. The flexibility these benefits give the business are endless. A different benefit can be created for every employee to whom it offers this arrangement. Unlike qualified plans, nonqualified deferred compensation is not bound by contribution limits, vesting, nondiscrimination, top heavy rules, coverage requirements or benefit accrual. Because of contribution limits, many high-income earners cap out the amount the IRS allows them to defer in qualified retirement plans and need other options for retirement income planning.

Provided Flexibility

- Nonqualified deferred compensation arrangements allow a business to be selective among “top-level” employees without concerns about government regulations like anti-discrimination rules or minimum funding requirements, which are required for qualified retirement plans
- A business can provide different benefit levels for different employees
- No government-mandated vesting rules apply
- Deferred compensation can be customized to suit individual situations
- Paperwork and administrative costs are kept to a minimum as compared to qualified plans

Funded vs. Unfunded Arrangements

Unfunded nonqualified deferred compensation arrangements are when the business does not set aside or earmark specific funds to cover the contractual obligation. The business may or may not have a reserve established. If there is a reserve established, it is still considered an asset of the business and subject to claims from creditors of the business. The employee does not have any beneficial right to the reserve assets.

Funded nonqualified deferred compensation arrangements, on the other hand, do have specific funds set aside in a reserve to meet the future contractual obligation. These reserves are not part of the business’s assets and therefore are not subject to the claims of creditors. However, a funded agreement means the deferred amounts are included in the employee’s taxable income once there is no longer a substantial risk of forfeiture.

The employees may be concerned with the security of an unfunded arrangement and the possible tax inclusion of a funded arrangement. There is a solution that combines financial security while keeping tax deferral, called a rabbi trust.

A rabbi trust is an irrevocable trust designed to hold the assets outside of the business or possible future successors. This offers the employees more security while still allowing the deferral of taxes. The IRS has provided guidance on rabbi trusts and even has issued a model rabbi trust agreement.¹⁰ The trust does provide protection from the business accessing the reserves, but it does not fully protect the reserves from the general creditors of the business, if it goes bankrupt or insolvent. The IRS views this as a substantial risk of forfeiture and allows the reserved funds to remain tax deferred, because the employee does not have constructive receipt or an economic benefit to the funds.

¹⁰ IRS Revenue Procedure 92-64



HOW IT WORKS

Life insurance can play a role in informally funding the unfunded deferred compensation arrangement without losing the ability to defer income tax. This benefits the business by creating a cost-effective way to pay the future benefits with little or no impact to future earnings.

Step 1

Deferring Income

The employee defers a percentage of their pretax salary and/or bonus for a period of years. In return, at the retirement or death of the employee, the employer provides supplemental retirement income for the employee and their family.¹¹

Since the deferred compensation benefits are an unsecured promise by the employer and are subject to the claims of the employer's creditors, the employee is not taxed until the income is distributed.

Step 2

Purchasing Life Insurance

The employer purchases a permanent life insurance policy on the life of the executive, suitable to his or her risk tolerance, time horizon, and financial goals.

The employer is the owner of the policy and names itself as the beneficiary. The employee is the insured.

The policy may offer a death benefit free of income tax, grow tax-deferred, and may accumulate a tax-deferred cash value for the employer.¹² Premium payments are not deductible to the employer.

Step 3

Receiving Income

When the employee retires or at another previously specified occurrence, he or she begins receiving the deferred salary from the employer, at which time the amount paid is deductible by the employer and taxable to the employee.

The employer can use the accumulated net cash value, through withdrawals or policy loans,* to fund the benefit payments.

Step 4

Beneficiaries

In the event of the employee's death, the plan may provide that his or her beneficiaries receive either a taxable annual income or a taxable lump-sum death benefit, depending on plan design, funded by the policy proceeds received by the employer.

¹¹ These plans are subject to the requirements of IRC 409A and ERISA "Top Hat" limitations of 29 U.S.C. §§ 1021-1031 and 1131-1145

¹² Notice and consent requirements and other provisions of IRC 101(j) must be met. Employer must also follow annual reporting requirements of IRC 6039I.

* Loans, withdrawals, and death benefit accelerations will reduce the policy value and death benefit and may increase the chance of the policy lapsing. Provided the policy is not and does not become a modified endowment contract (MEC), 1) withdrawals are tax-free to the extent that they do not exceed the policy basis (generally, premiums paid less withdrawals) and 2) policy loans are tax free as long as the policy remains in force. If the policy is surrendered or lapses, the amount of the policy loan will be considered a distribution from the policy and will be taxable to the extent that such loan plus other distributions at that time exceed the policy basis.

The Advantage

With the nonqualified deferred compensation plan, both the employer and employee benefit. Depending upon the design of the plan, here's how:

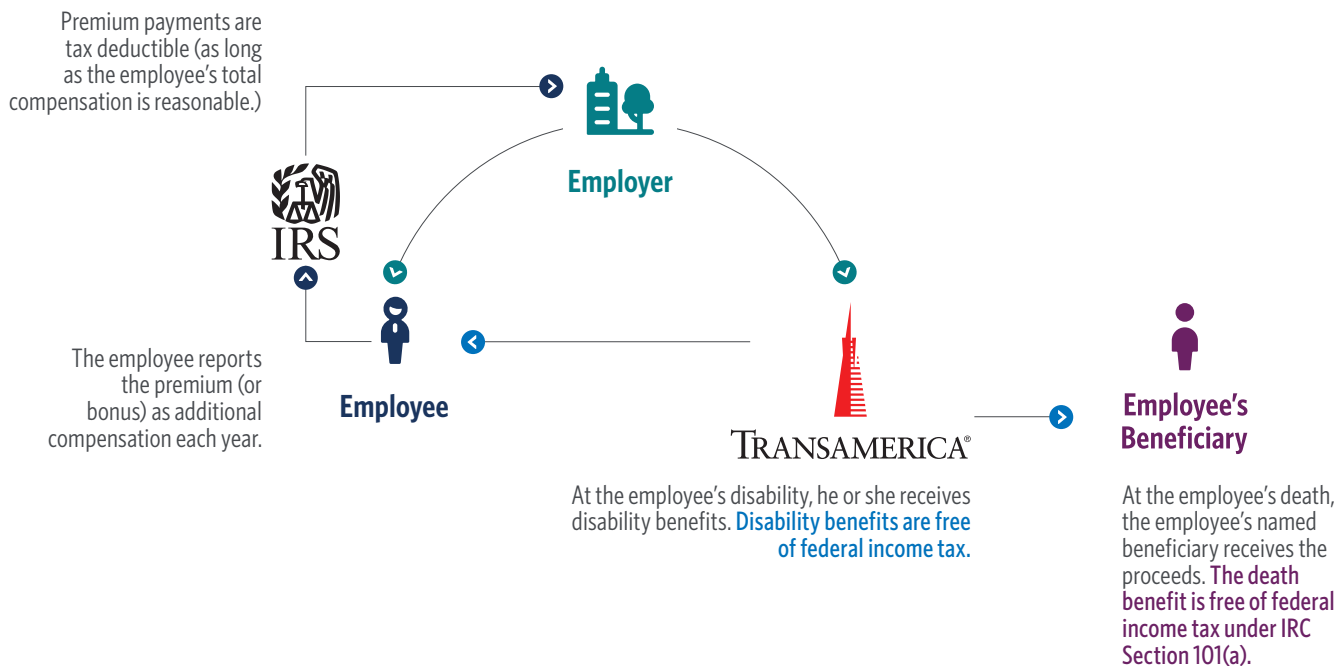
The Employee

- Reduces taxable income in deferral years
- Has customizable income deferral opportunities not subject to qualified plan limits
- Accumulates tax-deferred retirement benefits until distribution
- Can provide a preretirement survivor benefit

The Employer

- Has minimal legal requirements
- Controls the plan, owns the life insurance policy, and can include the cash value of the life insurance policy as an asset on the company's balance sheet
- Provides selected key employees with additional deferral opportunities different from those available to other employees
- Gains an attractive tool for recruiting, retaining, and rewarding talented executives by providing additional retirement income
- Receives an income tax deduction when benefits are paid out to the executive
- Enjoys greater flexibility in plan design
- Life insurance policy can provide for cost recovery with its benefit being free of income tax. However, the death benefit may be subject to the corporate Alternative Minimum Tax.

HOW A DEFERRED COMPENSATION ARRANGEMENT WORKS (FUNDED WITH LIFE INSURANCE)



1. The employer and employee enter into a written deferred compensation agreement. The employer gives the employee notice and obtains consent to the life insurance.
2. The employer applies for an insurance policy on the employee's life to "informally fund" its obligations under the agreement.
3. When the employee satisfies the conditions to receive benefits, the employer begins to pay retirement (or disability) benefits from the policy values, subject to federal income tax rules regarding policy withdrawals, loans, and surrenders.
4. At the employee's death, the employer uses the insurance proceeds to pay a death benefit to the employee's beneficiary (if the arrangement so provides).



SECTION 457 DEFERRED COMPENSATION PLANS

Alternatives for State and Local Governments and Agencies and Tax-Exempt Organizations

Many tax-exempt organizations offer a combination of tax-deferred qualified and nonqualified retirement plans to stay competitive as employers.¹³ Several types of these nonqualified deferred compensation plans are found under Internal Revenue Code Section 457. Section 457 plans sponsored by government employers have unique rules and benefits.

Eligible Section 457(b) Plans

In 2020 and 2021, the law allows pretax contributions up to **\$19,500** or up to 100% of “includible compensation,” whichever is less, to an eligible 457(b) plan.¹⁴ It may also allow additional catch-up contributions or elective deferrals of **\$6,500** by participants age 50 and older.

Amounts payable under an eligible plan are generally not subject to a vesting requirement and are paid to an employee or his or her family upon separation from service, retirement, or death. Generally, distributions must meet the minimum distribution requirements of qualified plans. Under certain circumstances, these amounts may be transferred from one eligible 457(b) plan to another.

Ineligible Section 457(f) Plans

Some tax-exempt organizations may also want to offer certain employees the ability to defer compensation in excess of the eligible amount through an ineligible plan (often called a Section 457(f) plan, pertaining to the Internal Revenue Code section). A 457(f) plan must be a “top hat” plan that covers only a select group of management or highly compensated employees. Also, the contributions and earnings must remain the property of the employer and are subject to the employer’s creditors.

Under an ineligible plan, employees may make tax-deferred contributions in excess of the eligible 457 limits as long as the amount of the deferred compensation is subject to a substantial risk of forfeiture. A substantial risk of forfeiture means that the employee must work for the tax-exempt organization until retirement, or a date specified in the agreement in order to receive benefits under the 457(f) plan. If he or she chooses to leave the organization or is involuntarily terminated before the date specified in the document, the deferrals, as well as their growth, may be forfeited and kept by the employer. In the first taxable year after the substantial risk of forfeiture has lapsed, the employee must include all of the account earnings up to the date of the lapse in his or her gross income. While this is also a salary deferral plan, the employer may increase the employee’s compensation — pay a bonus — to allow the employee to have enough income to comfortably defer a portion of his or her salary to the ineligible plan. Please note that the 457(f) plan must also meet the requirements of IRC § 409A, created by the American Jobs Creation Act of 2004.

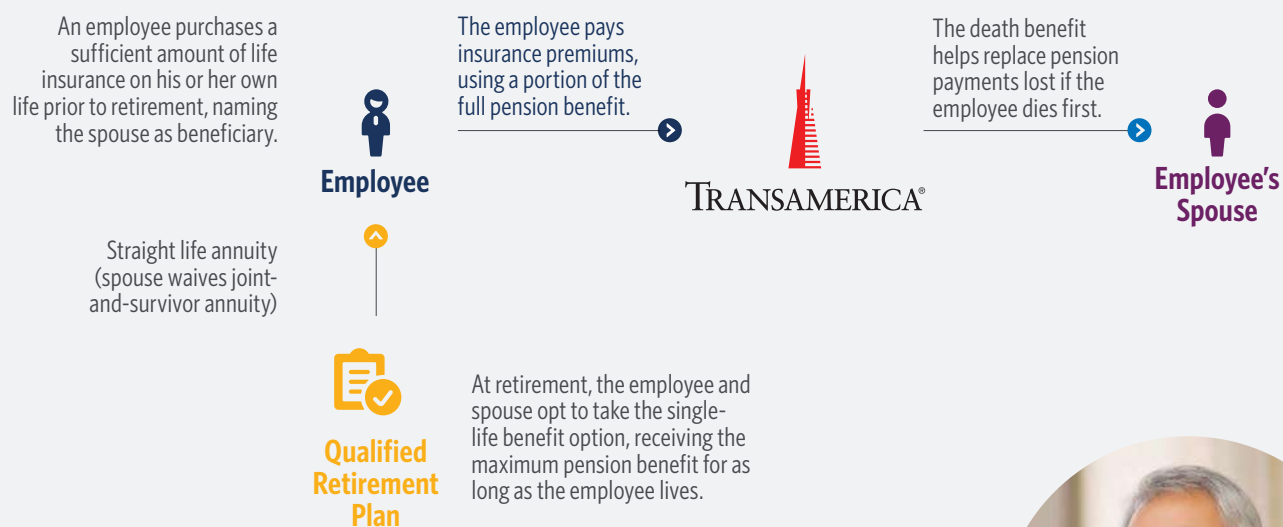
¹³ Plans of churches/synagogues/qualified church-controlled organizations as defined in the tax code are not subject to the Section 457 requirements and may be able to be more flexible in their design of deferred compensation plans.

¹⁴ Includible compensation is currently taxable compensation and thus excludes employee contributions made to a 401(k) plan, SEP, SIMPLE retirement account, or a 403(b) plan, and other nontaxable amounts. If an employee contributes to one of these types of plans or accounts, his or her includible compensation will be lower than his or her actual income.

Life Insurance to Supplement a Qualified Retirement Plan

Many employees may want to add supplemental protection to their retirement assets. Employees that are granted a defined benefit pension plan may want to evaluate the payout options offered through the plan. One manner to evaluate these options is to consider the single life option with a portion purchasing a life insurance policy versus taking the survivor payout.

HOW PENSION INCOME SUPPLEMENTAL LIFE INSURANCE WORKS



1. An employee purchases a sufficient amount of life insurance on his or her own life prior to retirement, naming the spouse as beneficiary.
2. At retirement, the employee and spouse opt to take the single-life benefit option, receiving the maximum pension benefit for as long as the employee lives.
3. The employee pays insurance premiums, using a portion of the full pension benefit.
4. The death benefit helps replace pension payments lost if the employee dies first.



A Win-Win Situation

The state and local governments and agencies or tax-exempt organizations:

- Encourage long-term executive loyalty
- Provide selected employees with attractive benefits

The employee:

- Enjoys tax-deferred supplemental retirement savings
- Receives valuable taxable death benefit protection if they die while working for the organization

A nonqualified plan, such as an eligible Section 457(b) or ineligible Section 457(f) plan, is a staple of many employee compensation programs. State and local governments and agencies and tax-exempt organizations should be quick to embrace the flexibility these plans allow in providing long-term and performance-based benefits.

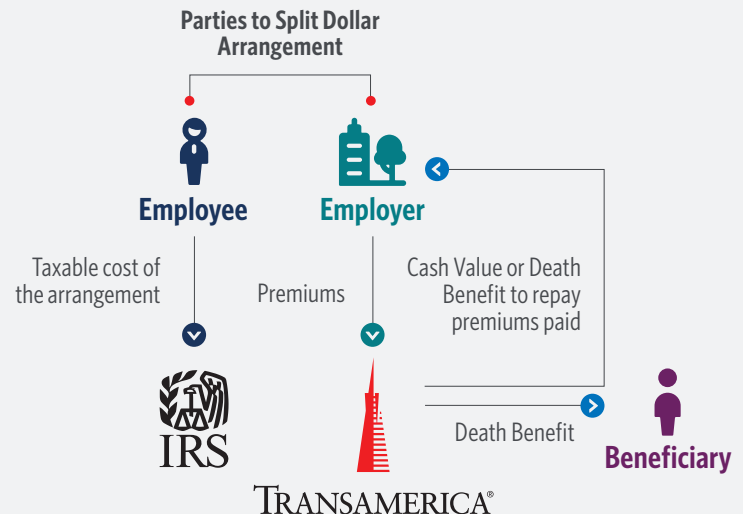
SPLIT-DOLLAR ARRANGEMENTS



WHAT IT IS

Simply put, a split-dollar arrangement is an agreement between two or more parties wherein the owners and non-owners of a life insurance contract specify their obligations and benefits.

In a business setting, the parties to the arrangement are generally the employer and an employee.



Typically, an employee owns the policy and assigns it to the employer; though this differs under the endorsement structure explained later. The responsibility of premium payments rests with the employer, but these premiums are nondeductible. The tax burden for policies under a split-dollar arrangement falls to the employee, but at a rate that is generally less expensive than the employee purchasing permanent life insurance on their own. The details of specific arrangements vary, but generally the employer recovers the premiums paid upon the death of the employee. Other arrangements may have the employer receiving the cash value, a portion of the death benefit, or both in addition to repayment of the premiums. Again, all split-dollar arrangements are unique and can be tailored to the specific needs of both the employer and the employee. Any leftover death benefit, cash value, or combination of the two remaining after the arrangement's duty to repay the employer are then given to the employee's named beneficiaries on the policy.

Benefits of a Split-Dollar Arrangement

A split-dollar arrangement can be beneficial to all parties of the agreement. The benefits below are in addition to the split-dollar arrangement's relatively low administrative costs and ease of implementation.

When it comes to employees, there are two major benefits that come to mind:

- A split-dollar arrangement can assist employees in transferring wealth to future generations
- An agreement can provide the employee with a permanent life insurance policy at a reduced personal expense

An employer can also benefit from a split-dollar arrangement. Employer benefits include:

- Another way to add and retain talented employees
- The opportunity to recoup their cost of the policy via access to the policy's cash value, through loans or withdrawals*, or from the policy's death benefit
- Selectivity in participants unlike other plans that are required to be offered to all eligible employees

SPLIT-DOLLAR OWNERSHIP STRUCTURES

There are two essential ownership models for a policy created under a split-dollar arrangement: the endorsement method and the collateral assignment method. While there are more complex forms of ownership where there may be more than two owners, such as Irrevocable Life Insurance Trusts, and more, they still fall under either the endorsement or collateral assignment methods as described below.

Endorsement Method

Under the endorsement method, the business owns the life insurance policy and allows the employee participant to file an “endorsement” with the insurance company. Via this endorsement, the participant can name the beneficiary of the death benefit. How much of the death benefit they can endorse to their beneficiary is set forth in the split-dollar arrangement’s contract between the employee and employer. The endorsement is a supplement to the original policy and with most insurance carriers is a relatively simple form. The employer pays the policy’s premiums, and the employee pays the tax on the “economic benefit” they receive (discussed in more detail in the tax consequences section).

Upon the participant’s death, the endorsed death benefit amount would be paid to the employee’s named beneficiaries. Any remaining benefit would be paid to the employer to recover premiums paid, to finance a buyout of the employee’s ownership interests, or to satisfy any number of possible terms defined in the split-dollar arrangement. Should the employee separate from service and terminate the arrangement, the company may either keep the policy and remove the former participant’s endorsement or transfer the policy to the participant. If the policy is transferred to the ex-employee, the value of the policy would be treated as taxable income to the participant. If the employee does not want the policy, the company may access the cash value to recover any premiums paid.

Collateral Assignment Method

Unlike the endorsement method, a policy using the collateral assignment method is owned by the participant, not the employer. Aside from this detail, the arrangement itself is pretty much the same in that it outlines the responsibilities of each party, how the policies proceeds are to be divided upon death, and what happens should the arrangement terminate. The payment of premiums is the responsibility of the employer, while the employee reports the economic benefit for tax purposes.

Another difference between the methods is that rather than an endorsement being filed, the employee files a “collateral assignment” naming the company. Generally, this is a one- or two-page document that is filed to accompany the policy. The collateral assignment essentially prohibits the employee from transferring ownership of the policy, borrowing from the policy, or making material modifications to the policy without the consent of the collateral assignment designee who in this case is the business.

The methods are the same should the employee die wherein the company and beneficiaries receive the amounts agreed upon in the arrangement. Since the employee owns the policy and can take it with them, termination of the arrangement differs slightly because the company has been paying the premiums. The arrangement can either define repayment or forgiveness of the premium amount. In the case of forgiveness, the amount of debt forgiven would be included in the participant’s income.



* Loans, withdrawals, and death benefit accelerations will reduce the policy value and death benefit and may increase the chance of the policy lapsing. Provided the policy is not and does not become a modified endowment contract (MEC), 1) withdrawals are tax-free to the extent that they do not exceed the policy basis (generally, premiums paid less withdrawals) and 2) policy loans are tax free as long as the policy remains in force. If the policy is surrendered or lapses, the amount of the policy loan will be considered a distribution from the policy and will be taxable to the extent that such loan plus other distributions at that time exceed the policy basis.

Tax Consequences of Split-Dollar Arrangements

An argument can be made that split-dollar arrangements are one of the most cost-effective benefit options that employers can provide to employees despite their lack of tax deductibility. The relatively low front-end administrative costs of drafting the arrangement and the ability to recover the costs of premiums via the policy's cash value or death benefit make split-dollar arrangements one of the more economical benefits that a business can provide to its most valued associates.

Given the only two certainties in life are death and taxes, the split-dollar arrangement is not without some tax liability. That liability falls on the participant and is based on the "economic benefit" received by the employee as determined using one of two methods. In the first method, illustrated below, the participant uses IRS Table 2001 to establish what the amount of economic benefit to include in their gross income. The illustration below assumes a \$1.5 million policy wherein half of the death benefit goes to the participant's beneficiaries. As the illustration shows, the economic benefit increases as the employee ages. The reason for this will become a little clearer when we discuss the second method of determining the economic benefit.

		AMOUNT INCLUDED IN PARTICIPANT'S GROSS INCOME
PARTICIPANT'S AGE	PARTICIPANT'S DEATH BENEFIT	PER IRS TABLE 2001 ¹⁵
40	\$750,000	\$825.00
45	\$750,000	\$1,147.50
50	\$750,000	\$1,725.00
55	\$750,000	\$3,112.50
60	\$750,000	\$4,882.50
65	\$750,000	\$8,925.00

The second method for determining the participant's economic benefit is via the cost of a one-year term policy for the participant's benefit amount at their current age; at the end of the year, or on the anniversary date of the policy. Using the illustration above, a one-year term policy for \$750,000 at age 45 may be significantly cheaper than Table 2001's implied economic benefit. The issue with this method is that the IRS requires that the term policy values used are regularly available and regularly sold in order to be used to ascertain economic benefit. Unfortunately, not many insurance providers offer one-year term policies with a regularity meeting these criteria. Depending on the insurer and available products, a tax professional should be consulted to determine the method used to establish the participant's tax liability on a split-dollar arrangement.

How to Implement a Split-Dollar Arrangement

An argument could be made that the implementation of a split-dollar arrangement is considerably easier than most employer-sponsored benefits due to its discriminatory nature and low administration costs. Both the employee and the employer should enlist attorneys to draft the agreement and outline the arrangement as it pertains to each party's responsibilities and benefits. These include, but are not limited to, the ownership structure of the policy, the division of the policy's benefits (both cash value and death benefit), premium payment responsibility, and what happens should the employee die or otherwise separate from service. Of course, all arrangements are unique and can be drawn up to meet the specific demands of virtually any situation. Ongoing administration of the arrangement is looked at as a cost to the business and a taxable benefit to the employee. Contact a tax professional to see how you would be impacted in your unique situation.

Once an arrangement has been defined, it is all a matter of finding a competitively priced insurance product that meets your needs.

¹⁵ IRS Notice 2001-10





BUSINESS SUCCESSION

Like estate or retirement planning, business succession planning is something that most business owners, no matter how financially or professionally savvy, would rather put off indefinitely.

When business owners do not make any contingency plans to transfer the business in the event of retirement, disability, death, or other circumstance resulting in a separation from the business, negative consequences can arise for the owner, his or her loved ones, the remaining owners, employees, and the business itself. The death or disability of a principal owner of a closely held business can create serious financial problems for the estate, the business, and the survivors of the deceased. In fact, studies show that a little more than 30% of all family-owned businesses survive into the second generation and only 12% into the third generation.¹⁶ Certified professionals, such as engineers, attorneys, accountants, or financial professionals, have an even smaller pool of potential candidates because the successor would also need the correct credentials and certifications to take over the business. Thus, even if these individuals wanted to create a business succession plan, they may have to go through the process of locating a third-party buyer at a potential bargain price.

¹⁶ "Solving Succession Problems in Family-Owned Businesses," Gallup, April 2019

BUY-SELL AGREEMENTS



WHAT IT IS

Having a buy-sell agreement in place can help business owners mitigate conflict and speed up the transition by creating a road map for the future of the business.

A buy-sell agreement is a legally binding contract that can be used with all types of businesses. It stipulates that upon a triggering event, such as the death, retirement, disability, or other withdrawal of a principal, his or her share of the business must be sold to the remaining partners or shareholders, or to the business itself. The remaining partners, shareholders, or the business itself agree to purchase the portion of the business owned by the deceased, retired, disabled, or withdrawing principal. The agreement helps to prepare for the owner's withdrawal from the company. For example, life insurance may be purchased to fund the agreement on the death or retirement of an owner.

KEY PROVISIONS OF A BUY-SELL AGREEMENT

The buy-sell agreement, regardless of form, must be drafted by an attorney and should specify certain key provisions. It is critical that the buy-sell agreement set out the intent of the parties in a manner that meets all legal requirements. The following information must be known for insurance planning and must be clearly explained in the buy-sell agreement:



Parties:

Who will be selling and who will be buying?



Must mandate sales and purchase:

The buy-sell agreement must state that it is mandatory for the seller to sell and for the buyer to buy the business interest.



What is to be purchased:

This differs with each business type. For instance, it could be partnership interests, membership interests, stock; or for a sole proprietorship, the business's assets.



Business valuation (price):

How much does the owner or the owner's estate get for his or her business interest and how much does the buyer have to pay for this business interest?



Timing of the sale:

For all parties involved, timing of the sale is critical.



Law:

Which state law(s) will apply?



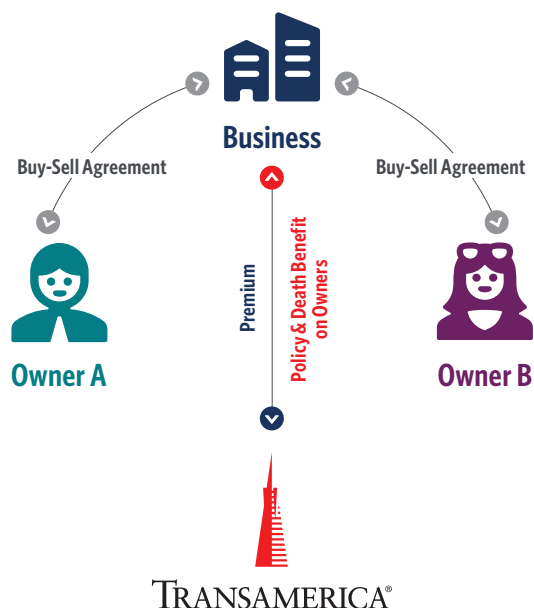
Changes to the agreement:

A buy-sell agreement usually exists for a number of years. The process to update insurance coverage should be established.



Termination of the agreement:

There are valid reasons to terminate a buy-sell agreement, so having an exit provision can be useful.



ENTITY (REDEMPTION) BUY-SELL AGREEMENT

The entity buy-sell agreement is generally used with any business entity that has multiple owners who want to use the assets of the business to fund the agreement. The business is the purchaser, owner, premium payor, and beneficiary of life insurance policies on each owner's life. When an owner dies, the business receives the death benefit and uses the proceeds to purchase the business interest from the deceased owner's estate. The estate is paid the agreed-upon price, and the surviving business owners own the entire business.

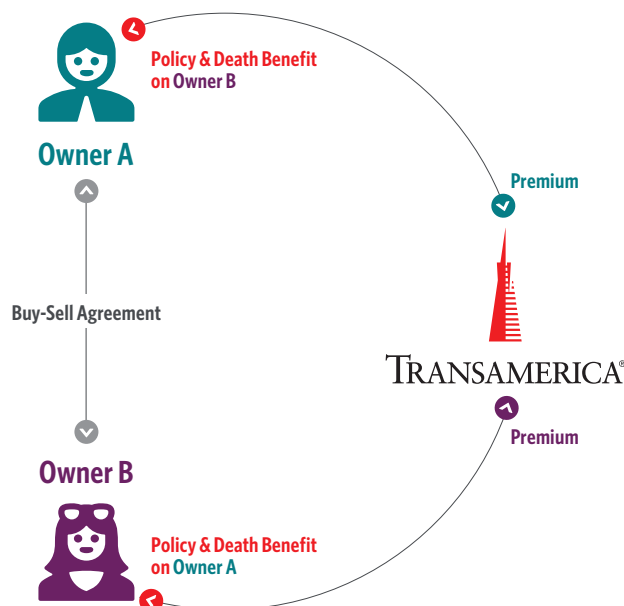
This is a form of EOLI, and the business will follow all notice and reporting requirements under IRC § 101(j) and IRC § 6039I. The business will show the life insurance policy cash value as a business asset. However, premiums paid by the business are not tax deductible. Entity buy-sell agreements may not be as advantageous for closely held businesses because family attribution rules may result in unforeseen tax consequences.

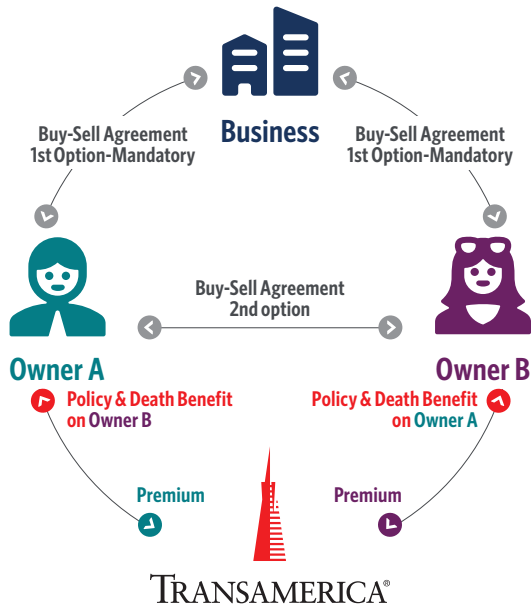
CROSS-PURCHASE BUY-SELL AGREEMENT

With this arrangement, each business owner purchases life and/or disability insurance on the other business owner(s). Each owner is the beneficiary of his or her respective policy(ies). The business is not part of the agreement. Upon the disability, death, or withdrawal of one owner, the remaining business owner(s) can use the policy proceeds or cash value to purchase their pro rata shares of the withdrawing owner's interest in the business.

In the case of sole owners, this agreement can be structured as a one-way agreement, where a buyer such as a key employee or third-party purchases a life insurance policy on the sole business owner.

At the owner's death or retirement, the buyer uses the policy proceeds or cash value to purchase the owner's entire business.





WAIT-AND-SEE BUY-SELL AGREEMENT

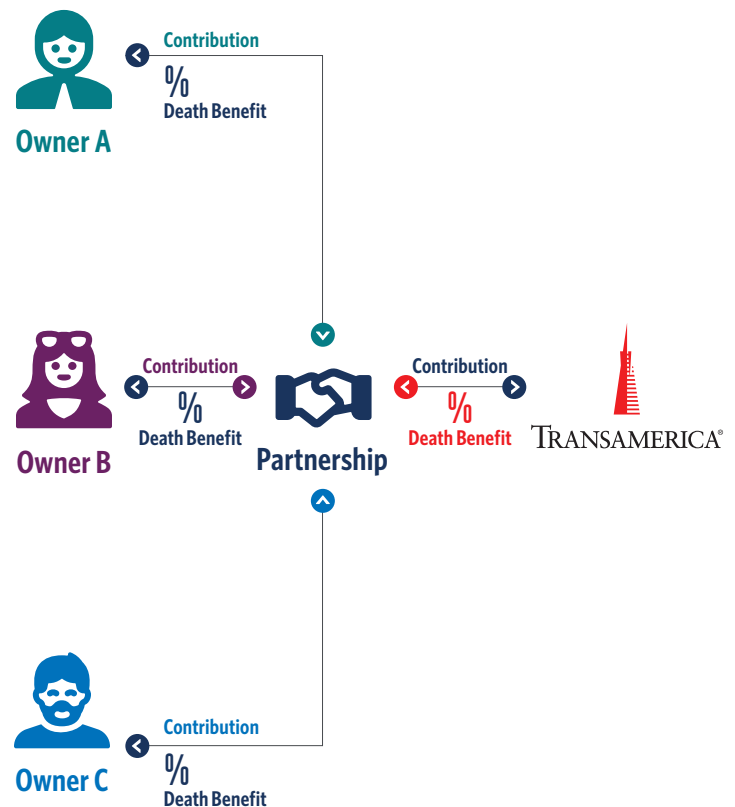
The primary advantage of the “wait-and-see” buy-sell agreement is its flexibility. Choosing between a cross-purchase and entity buy-sell agreement can be challenging because of the inability to predict the future and determine which plan will be better for all parties. The wait-and-see agreement can adjust to future tax law changes, fluctuating economic times, or owner uncertainty. The wait-and-see is a hybrid agreement containing language of both previously mentioned buy-sell agreements which allows either the surviving principal(s) or the business itself to purchase the withdrawing owner’s interest. The decision is not made until an owner actually withdraws from the business.

COMBINATION BUY-SELL AGREEMENT

The combination buy-sell is a nontraditional arrangement in which a general partnership is used to structure and fund a business buy-sell. This special arrangement combines the benefits of both a cross-purchase and stock redemption/entity purchase, while avoiding their negative aspects. With this arrangement — in addition to establishing a traditional buy-sell agreement for the business — the owners of the business establish a separate general partnership, which owns and names itself beneficiary of life insurance policies insuring the lives of the owners. The owners make contributions to the partnership to fund the payment of the premiums.

At the death of one of the owners, and according to the terms of the buy-sell, the death benefits can be:

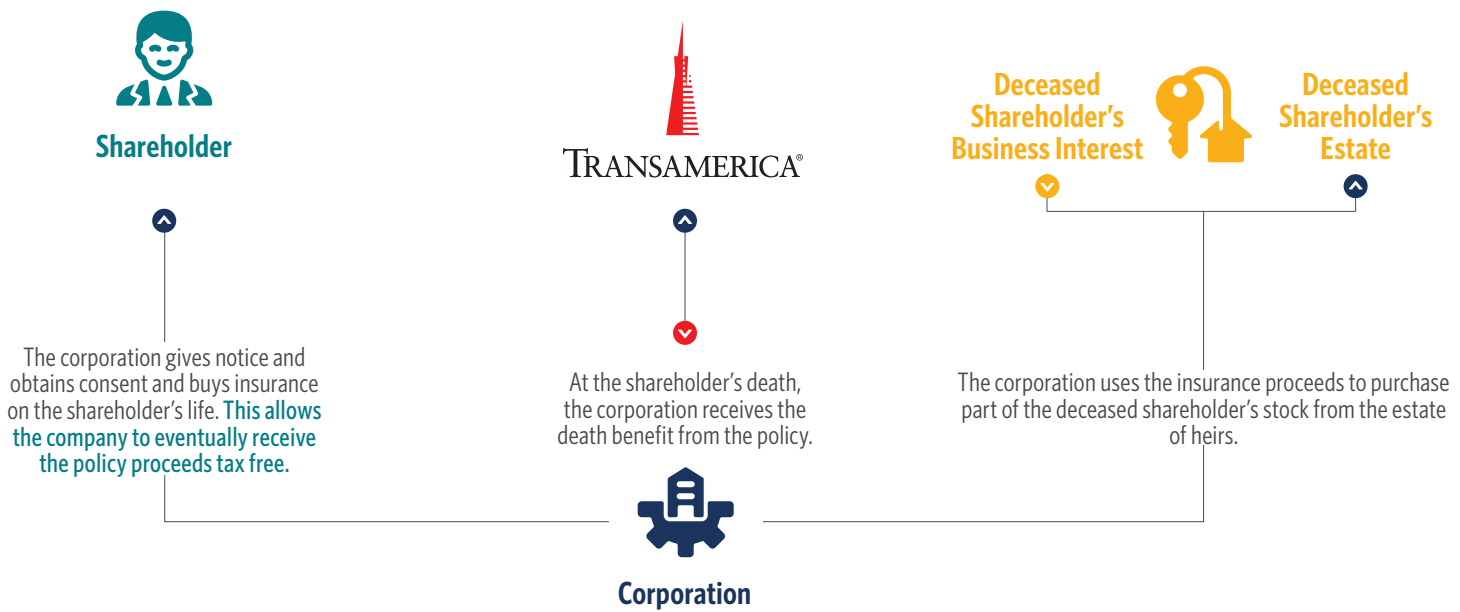
- Distributed to the surviving owner(s)/ partner(s) to fund a cross-purchase-type buyout
- Lent by the surviving owners to the business to fund a stock redemption or entity purchase, or
- Used by the partnership to buy the deceased owner’s interest





SECTION 303 STOCK REDEMPTION

The 303 stock redemption is used for family corporations or closely held businesses, which the owner wishes to keep in the family. If the deceased owner’s shares are valued at greater than 35% of the gross estate, IRC § 303 will allow his or her estate or heirs to sell to the closely held business enough stock to pay certain taxes and costs. The maximum amount of stock that may be sold to the business under IRC § 303 is limited to the total of state and federal estate taxes, costs of administering the estate, and funeral expenses.



BUSINESS VALUATION

The most important component of a buy-sell agreement is the valuation of the business. The different ways to value a business are as unique as businesses themselves. A job aid for IRS valuation analysts states, “No formula can be devised that will be generally applicable to the multitude of different valuation issues arising in estate and gift tax cases. Often, an appraiser will find wide differences of opinion as to the fair market value of a particular stock. In resolving such differences, he should maintain a reasonable attitude in recognition of the fact that valuation is not an exact science. A sound valuation will be based upon all the relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process of weighing those facts and determining their aggregate significance.”¹⁷ The IRS has provided guidance in *Revenue Ruling 59-60* for the eight factors involved in determining valuation of a closely held business:

1. The history of the company and the nature of the business
2. The economic environment in which the business will operate
3. The book value of the stock and the financial condition of the business
4. The earnings capacity
5. The dividend paying capacity
6. The existence of good will or other intangible values
7. The sale of the stock or size of the block of stock to be valued
8. The fair market value of publicly traded stock of comparable businesses

There are several methods to determining the purchase price in a buy-sell agreement. Only a properly structured buy-sell agreement will result in the purchase price being accepted by the IRS as the estate tax value of that business interest at an owner’s death. The purchase price or formula used to determine the value should result in a fair market value at the triggering event for the buy-sell agreement.

Methods can be as simple as a fixed price, or a complex formula method. A buy-sell agreement could dictate that the business be valued by an appraiser at the time of the death of an owner. A combination of methods could also be used.

OPTIONS FOR FUNDING A BUY-SELL AGREEMENT

Having a buy-sell agreement in place is crucial for business owners who want to ensure a trouble-free transfer, as well as the continuing vitality of their businesses. There are four primary ways to fund a buy-sell agreement:



Pay Cash

This requires large sums of liquid assets that may not be readily available, particularly when an unforeseen event occurs. The business may have to liquidate their valuable personal or business assets at below-market value to quickly raise enough cash.



Borrow the Money

The loss of an owner or key person may significantly impact the credit rating of the business and its ability to borrow. Additionally, the business owners must pay principal plus interest. This could be a tremendous strain on the business budget.



Installment Sale

Under an installment plan, the remaining owners of the business make regular payments to a departed owner or a deceased owner’s heirs in exchange for their share of the business. Deceased or departed owner/shareholder’s family would receive compensation over time rather than a lump sum and may rely on continued success of business to receive payment, which cannot be guaranteed.



Purchase a Life Insurance Policy

With a life insurance policy, money is available from the policy cash value or death benefit for the purchase of the business interest. This liquidity is available at the time it is needed without the need to raise funds by either selling the business or borrowing funds. Policy cash values grow tax deferred and death benefits are free of federal income tax.

¹⁷ “Valuation of Non-Controlling Interests In Businesses Electing To Be Treated As S Corporations For Federal Tax Purposes – A Job Aid For IRS Valuation Analysts,” Appendix A, Sec. 3.01, IRS, October 29, 2014

BUSINESS FACT FINDER (EXECUTIVE BENEFITS, KEY EMPLOYEE, BUY-SELL AGREEMENTS)

Company Identification

Name _____ Address _____
 City _____ State _____ ZIP _____ Telephone _____
 Entity Type ☐ C Corporation ☐ S Corporation ☐ Partnership ☐ Sole Proprietorship ☐ FLP ☐ LLC

	BUSINESS OWNERS	AGE	SEX	SMOKER Y/N	% OF OWNERSHIP	TAX BRACKET	RELATIONSHIP TO OTHERS
1.							
2.							
3.							
4.							
5.							

EMPLOYEE BENEFITS

What employee benefit plans do you have and how are they funded?

Pension Plan _____ Profit-Sharing Plan _____
 SEP _____ Group Health _____
 Group Life _____ Group Disability _____
 Other (Describe) _____

Are there any special benefit plans just for owners and key employees? If "yes," describe:

Do you plan to add anyone to the plan(s)? _____ If "no," have you considered any? _____

BUSINESS STABILITY

Do any owners have personal liability for business debts? _____

If "yes," are these debts covered by life insurance? _____

Are there key employees whose death or disability would jeopardize company profits? _____

What has been done to protect the business in the event of death or disability of one of these key employees? _____

If key employees are insured, who are the insured? _____

If not insured, who should be? _____ Is the insurance adequate today? _____

BUSINESS CONTINUITY

What are the names and ages of any relatives or children who may enter the business?

In the event family members are too young or lack experience, who would run the business?

What have you done to guarantee that this person(s) will stay?

Do you have a Buy-Sell Agreement? (Y/ N)

What type? ☐ Entity or Stock Redemption ☐ Cross-Purchase ☐ Wait-and-See ☐ Combination ☐ Section 303 Redemption

If “yes,” when was it last reviewed? _____ Is it funded with life insurance? _____

If funded with insurance, when was the policy(ies) last reviewed? _____

How is the business value in the agreement determined? _____

If unknown or out-of-date: Book Value: What is the book value of your business? \$ _____

Earnings & Growth: Average earnings—last five years \$ _____ Capitalization rate (reflects risk of business/industry) _____ %

Years of goodwill (number of years that goodwill would last after owner’s death, generally higher for service than manufacturing)

Return of tangible assets _____ % Annual business growth rate _____ %

Estimate value of the business \$

Are there any other agreements concerning your business interest in existence?

If “yes,” please explain:

Does your will contain any provision regarding the disposition or retention of your business interest?

Does your will direct or authorize your executor to retain or operate the business?

COMPANY PROFESSIONALS

Accountant _____ Address _____

City _____ State _____ ZIP Code _____ Telephone _____

Attorney _____ Address _____

City _____ State _____ ZIP Code _____ Telephone _____

Other (Banker, etc.) _____ Address _____

City _____ State _____ ZIP Code _____ Telephone _____



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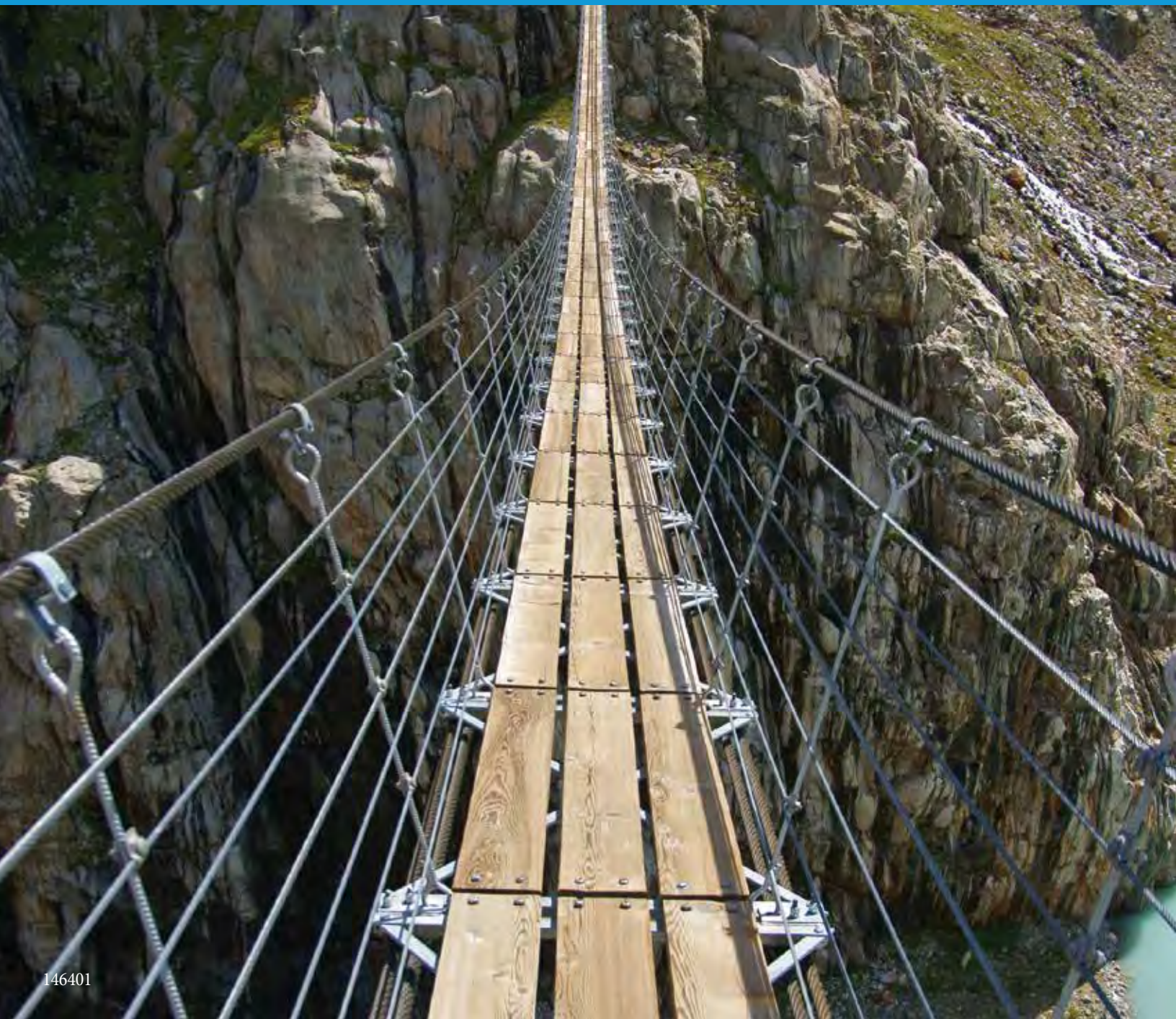


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› Business Owner Factfinder



INFORMAL BUSINESS VALUATION

Business Name _____

Business Owner Name _____ Other Contact Name _____

Tax ID _____ Phone Number _____ Fax Number _____

Address _____ City/State/ZIP _____

Email Address _____

Number of Years in Business _____ Total Number of Employees _____

Form of Business: ☐ Sole Proprietorship ☐ Partnership
☐ S Corp ☐ C Corp
☐ LLC ☐ Other (please describe) _____

Do you plan on changing the business organizational form in the near future? _____

What is your estimate of the value of your business? _____

Have you had a formal appraisal? When was it done? What was the value? _____

What is your projected revenue growth? _____

What percentage of your business is recurring? _____

What percentage of your sales comes from your top three customers? _____

What would be the impact on revenues and profits if the owner(s) leave?

☐ No impact ☐ Decline minimally ☐ Significant decline ☐ Plummet

IMPORTANT:

Attach the most recent **three** years of the following:

- Income statement/Profit and loss statement
- Balance sheet
- Company tax returns

Also, if prepared, please attach these documents:

- Cash flow statements
- Statements of owner's net
- Most recent valuation or appraisal

This completes the information required for an informal business valuation. If you want a more detailed business succession planning or personal planning analysis, please continue to complete the appropriate sections of the factfinder on the following pages.

The purpose of this information is to assist the business owner in the furtherance of their planning. A formal appraisal would be needed to establish the value for tax purposes or prior to a transfer.

TRANSFERRING YOUR BUSINESS

Are you planning on retiring?

When, and what plans have you made to provide for your retirement income needs? _____

What does your ideal exit plan from your business look like? _____

What specific plans have you made for the continuation of your business? _____

Have you designated successor management? _____

If the business is to be retained...

Who could manage the business tomorrow? _____

How will spouse/family receive income from the business? _____

Will additional cash in the business be needed to smooth out the transition? _____

If the business is to be sold...

Who will buy the business? _____

Do you have a written plan to transfer your company ownership? _____

If yes, what is the agreed upon price? _____

How current is your plan? _____

How was the valuation determined? _____

How is the plan funded? _____

If the business is to be transferred...

When and who will you transfer management control to? _____

When and who will you transfer ownership to? _____

If the business is to be liquidated...

What price would liquidation bring? _____

What arrangements have you made, if any, to make up the difference between this and the fair market value of your business? _____

PROTECTING YOUR BUSINESS

What would happen to your business if...

Something happened to your key employees (sick, leave or die)? _____

You couldn't come back to work (die or disabled)? _____

In the event of you or another owner's disability, would additional funds be needed to help the business pay for normal operating expenses? ☐ Yes ☐ No How much \$ _____ How long? _____

Do you currently have a plan in place to pay for these expenses? _____

Salary Continuation

At owner's disability, will salary/draw be continued?

☐ Yes ☐ No How much? \$ _____ How long? _____

At a key employee's disability, will salary be continued?

☐ Yes ☐ No How much? \$ _____ How long? _____

At another employee's disability, will salary be continued?

☐ Yes ☐ No How much? \$ _____ How long? _____

Do you have any DI coverage to fund your plan? _____

Current or Desired Employee Benefit Plans

Does the business have any of the following plans in place for owners? Employees? Please explain.

- Retirement plans (e.g., 401(k), SIMPLE, SEP): _____
- Disability Income: _____
- Long-term Care: _____
- Other: _____

BUSINESS OWNED LIFE INSURANCE

Insured	Insurance Company	Type of Policy	Insurance Benefit	Cash Value Benefit	Annual Premium	Policy Loans

Total Life Insurance Benefits In-force _____

PROTECTING YOUR FAMILY

What would happen to your family if...

You couldn't work in your business? _____

When you retire, become disabled or die, what do you want to happen to your business interest? _____

When a partner/owner retires, dies, or becomes disabled, do you want to buy their interest? ☐ Yes ☐ No

• Do you feel you and your family are financially prepared if something happens to you? _____

• What amount of money would provide your family an adequate standard of living should something happen to you? _____

• In the event of your death, what percentage of your monthly income should be provided for your family's continuing income needs? _____

CURRENT LIFE INSURANCE IN-FORCE						
Owner (A/B) (Mark "A" if "Client A") (Mark "B" if "Client B")	Insurance Company	Type of Policy (Group, Term, UL, Whole Life, etc.)	Insurance Benefit	Cash Value Benefit	Annual Premium	Beneficiaries

Total Life Insurance Benefits In-force _____

• In the event of your death, would you like your children's college education to be partially or fully funded?

☐ Yes ☐ No

• What impact would being out of work due to an injury or illness have on your family's financial future? _____

Percentage of income to replace: Client A _____

Client B _____

CURRENT DISABILITY INCOME INSURANCE IN-FORCE						
Owner (A/B) (Mark "A" if "Client A") (Mark "B" if "Client B")	Insurance Company	Individual or Group Policy	Monthly Benefit	Elimination Period	Benefit Period	COLA Rate

Critical Illness

Whom do you know that has had cancer, a heart attack, or a stroke? _____

Do you currently own a critical illness policy? If so, what is the coverage amount and the premium?

Retirement Planning

• What are your thoughts or concerns about your retirement? _____

• Is there anything special you want to do in retirement? _____

At what age do you plan to retire?

Client A _____ Client B _____

At what age will you begin to collect Social Security?

Client A _____ Client B _____

Are you currently saving for retirement?

☐ Yes ☐ No

PROFESSIONAL ADVISORS				
Advisor	Name	Address	Phone Number	Email
Attorney				
Accountant				
Banker				
Insurance Agent				
Financial Advisor				
Other _____				
Other _____				
Other _____				

NOTES

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



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BUSINESS ENTITIES

TYPE OF BUSINESS	OWNERSHIP STRUCTURE	LIABILITY	TAXATION
Sole Proprietorship — The simplest form of business; the business doesn't have a separate legal existence from the owner	Unincorporated — Single owner and business are one and the same for legal and tax purposes	Owner has unlimited personal liability.	<ul style="list-style-type: none"> Owner reports profits and losses on Schedule C and files with Form 1040 on his/her individual tax return. Potential 199A (Qualified Business Income) deduction of 20% depending on the specified trade or business and income phaseout limits
Partnership — Two or more owners (partners) who contribute to all aspects of the business and share in the profits and losses	Unincorporated — Two or more persons or entities	General partner has unlimited personal liability. Limited partner has liability to the total amount of investment in the partnership.	<ul style="list-style-type: none"> Partnership files a tax return with appropriate breakdown of total distributive share of each deduction, income, and credit Schedule K-1 on Form 1065. Schedule K-1 (Form 1065) is used to enter each partner's share and used by each partner for individual tax returns. Partners then report profits, losses, and deductions on Schedule E of Form 1040. Potential 199A deduction of 20% (eligibility based on specific business and income)
C Corporation — A legally independent entity owned by shareholders	Incorporated — One or more persons or entities	Full asset protection. Owners/shareholders have no personal liability.	<ul style="list-style-type: none"> A C corporation must file a tax return annually, even if it doesn't owe any tax or have any income (Form 1120). C corporations are taxed on profits at the entity level. Shareholders are taxed again on dividend distributions (Form 1099-DIV). Dividends paid to shareholders are not deductible by the corporation. C corporations can deduct a reasonable amount for salaries paid to officers and employees. Possible additional income tax for unreasonable amounts of earnings or profits not being distributed to shareholders

TYPE OF BUSINESS	OWNERSHIP STRUCTURE	LIABILITY	TAXATION
S Corporation — A legally independent entity owned by shareholders	Incorporated — One or more (up to 100) U.S. persons, estates, certain types of trusts, charitable organizations, and qualified retirement plans	Full asset protection. Owners/ shareholders have no personal liability.	<ul style="list-style-type: none"> Subchapter S corporations elect not to pay any corporate taxes on income but still must file an annual tax return (Form 1120-S). Tax liability is the responsibility of the shareholders even if/when income from the S corporation is not distributed to them. Potential 199A deduction of 20% (eligibility based on specific business and income)
Limited Liability Company (LLC) — A hybrid entity that joins the limited liability of a corporation with the pass-through tax advantages of a partnership	Unincorporated — One or more persons or entities	Owner(s) — No personal liability	<ul style="list-style-type: none"> An LLC can choose its federal tax classification as a Partnership (two or more members), S corporation, C corporation, or Sole Proprietor (single member) (Form 8832). Potential 199A deduction of 20% (eligibility based on specific business and income) if established as a pass-through for profits and losses
Family Limited Partnership — A unique limited partnership structure	Two or more family members or trusts for the primary benefit of family members (typically of different generations)	General partner has unlimited personal liability (usually older family member). Limited partner has no personal liability and is only liable to the total amount of investment in the partnership (usually second/third generation family member).	Same as Partnership

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A profile of customer opportunities

Who are your best sales prospects?






	General business market profile	Business succession cases	Key person insurance
 Top five industries	<ol style="list-style-type: none"> 1. Professional, scientific, & technical services 2. Construction 3. Manufacturing 4. Healthcare & social assistance 5. Finance & insurance 	<ol style="list-style-type: none"> 1. Professional, scientific, & technical services 2. Construction 3. Healthcare & social assistance 4. Manufacturing 5. Wholesale trade 	<ol style="list-style-type: none"> 1. Professional, scientific, & technical services 2. Construction 3. Manufacturing 4. Wholesale trade 5. Finance & insurance
 Employee size	<ul style="list-style-type: none"> • 1-99 employees: 77% – 1-4 employees: 21% – 5-24 employees: 33% – 25-49 employees: 13% – 50-99 employees: 9% • 100-1,000+ employees: 16% 	<ul style="list-style-type: none"> • 1-99 employees: 84% – 1-4 employees: 24% – 5-24 employees: 38% – 25-49 employees: 14% – 50-99 employees: 8% • 100-1,000+ employees: 9% 	<ul style="list-style-type: none"> • 1-99 employees: 81% – 1-4 employees: 21% – 5-24 employees: 35% – 25-49 employees: 15% – 50-99 employees: 10% • 100-1,000+ employees: 12%
 Years in business	<ul style="list-style-type: none"> • 25+ years: 43% • 11-24 years: 22% • 6-10 years: 11% • 1-5 years: 12% 	<ul style="list-style-type: none"> • 25+ years: 40% • 11-24 years: 25% • 6-10 years: 11% • 1-5 years: 12% 	<ul style="list-style-type: none"> • 25+ years: 40% • 11-24 years: 25% • 6-10 years: 11% • 1-5 years: 12%
 Annual sales volume	<ul style="list-style-type: none"> • < \$3 million: 49% • \$3.1 to \$10 million: 16% • \$10.1 to \$50 million: 14% • \$50.1 to \$500+ million: 8% 	<ul style="list-style-type: none"> • < \$3 million: 57% • \$3.1 to \$10 million: 16% • \$10.1 to \$50 million: 12% • \$50.1 to \$500+ million: 3% 	<ul style="list-style-type: none"> • < \$3 million: 51% • \$3.1 to \$10 million: 18% • \$10.1 to \$50 million: 13% • \$50.1 to \$500+ million: 5%
 Entity type	<ul style="list-style-type: none"> • Corporations (S or C): 62% • Partnerships: 7% • Sole proprietorship: 2% • Nonprofit: 4% 	<ul style="list-style-type: none"> • Corporations (S or 5C): 57% • Partnerships: 8% • Sole proprietorship: 3% 	<ul style="list-style-type: none"> • Corporations (S or C): 61% • Partnerships: 7% • Sole proprietorship: 2%

Source: Principal® business market analysis of over 25,000 plans is appended with Dunn & Bradstreet (D&B) data. The data is current as of December 2020. Statistics shown only include those plans with appended data. The overall match rate is 88%, and not all categories will add up to 100%.

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Business solutions

Who are your best sales prospects?

	Employer-paid retirement plans	Employee deferral retirement plans	Tax-exempt plans
 Top five industries	<ol style="list-style-type: none"> 1. Construction 2. Manufacturing 3. Professional, scientific, & technical services 4. Wholesale trade 5. Finance & insurance / retail trade 	<ol style="list-style-type: none"> 1. Manufacturing 2. Professional, scientific, & technical services 3. Finance & insurance 4. Wholesale trade 5. Construction 	<ol style="list-style-type: none"> 1. Healthcare & social assistance 2. Other services (business, professional, labor, political, & similar) 3. Finance & insurance 4. Arts, education, & recreation 5. Educational services
 Employee size	<ul style="list-style-type: none"> • 1-99 employees: 74% <ul style="list-style-type: none"> – 1-4 employees: 18% – 5-24 employees: 30% – 25-49 employees: 15% – 50-99 employees: 11% • 100-1,000+ employees: 21% 	<ul style="list-style-type: none"> • 1-99 employees: 30% <ul style="list-style-type: none"> – 1-4 employees: 5% – 5-24 employees: 7% – 25-49 employees: 7% – 50-99 employees: 11% • 100-1,000+ employees: 66% 	<ul style="list-style-type: none"> • 1-99 employees: 32% <ul style="list-style-type: none"> – 1-4 employees: 3% – 5-24 employees: 9% – 25-49 employees: 8% – 50-99 employees: 12% • 100-1,000+ employees: 67%
 Years in business	<ul style="list-style-type: none"> • 25+ years: 53% • 11-24 years: 19% • 6-10 years: 8% • 1-5 years: 7% 	<ul style="list-style-type: none"> • 25+ years: 61% • 11-24 years: 21% • 6-10 years: 5% • 1-5 years: 5% 	<ul style="list-style-type: none"> • 25+ years: 78% • 11-24 years: 12% • 6-10 years: 4% • 1-5 years: 3%
 Annual sales volume	<ul style="list-style-type: none"> • < \$3 million: 43% • \$3.1 to \$10 million: 17% • \$10.1 to \$50 million: 16% • \$50.1 to \$500+ million: 11% 	<ul style="list-style-type: none"> • < \$3 million: 13% • \$3.1 to \$10 million: 8% • \$10.1 to \$50 million: 26% • \$50.1 to \$500+ million: 43% 	<ul style="list-style-type: none"> • < \$3 million: 12% • \$3.1 to \$10 million: 16% • \$10.1 to \$50 million: 44% • \$50.1 to \$500+ million: 24%
 Entity type	<ul style="list-style-type: none"> • Corporations (S or C): 69% • Partnerships: 4% • Sole proprietorship: 2% • Nonprofit: <1% 	<ul style="list-style-type: none"> • Corporations (S or C): 81% • Partnerships: 4% • Sole proprietorship: <1% • Nonprofit: <1% 	<ul style="list-style-type: none"> • Nonprofit: 90%

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2023 Principal Business Owner Insights

Insights to help you plan for the future



We asked
what's
on the
minds of
business
owners
like you.



Small businesses are an important part of communities and can help strengthen the U.S. economy. While business and financial planning may not always make it to the top of your busy to-do list, putting plans in place may be easier than you think.

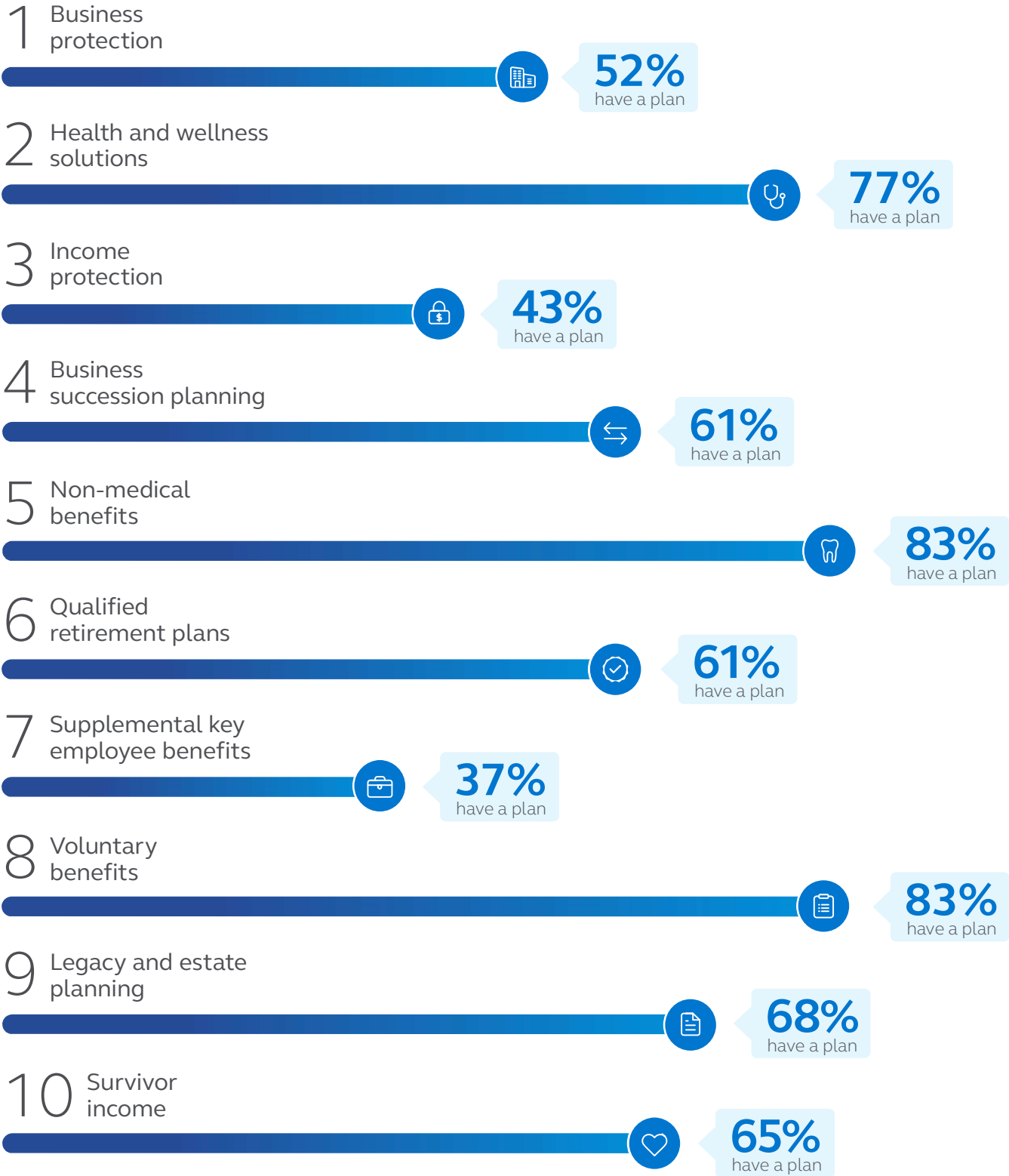
See what other business owners said in the survey. These insights can give you an inside look at what your peers are doing and provide some benchmarks to consider as you create your own priorities and action plan.

Using this guide

Snapshot of top priorities and realities	3
Are your priorities similar to or different from your peers?	4
Do you have the right team helping you?	6
What are the next steps?	7
About the survey	8

Snapshot of top priorities and realities

We asked business owners to rank their top priorities and whether they had a plan in place today. Even though business owners rank these as important, many still need help protecting what matters most.



Are your priorities **similar** to or **different** from your peers?

 Solutions for your **employees**. Stay competitive by offering benefits.

➤ **Health and wellness solutions** (#2 priority)

These are employer-sponsored programs that provide health-related benefits and organized activities to help employees maintain or improve their health.

What we heard — Comprehensive health insurance remains the most common solution (62%) with employee assistance programs (EAP) and emotional/mental wellness programs showing significant growth.

Planning tip: These solutions work together to keep employees healthy and working, and can be a valuable part of the benefits you offer to attract and retain employees.

➤ **Qualified retirement plans** (#6 priority)

These are retirement solutions, including 401(k) plans and traditional defined benefit plans that are generally available to the majority of employees.

What we heard — The 401(k) plan continues to be the most popular option offered (64%), and is showing significant growth.

Planning tip: Principal offers expertise in the major plan types, as well as service—to make it easier on you to maintain the plan. Talk to your financial professional to help you choose retirement benefits that work for your employees and business.

➤ **Non-medical (#5 priority) and voluntary benefits (#8 priority)**

Offered at the worksite, they can be employer-paid or employee-paid (voluntary) and typically include benefit options like dental, disability, life, and vision insurance.

What we heard — Owners are offering employee benefits at significantly higher levels compared to last year. And the number saying benefits improve employee retention, recruiting, and productivity has reached record levels.

Planning tip: These solutions can be designed to fit your needs and budget. See what similarly sized organizations in your industry and region offer for these types of benefits:
benefitdesigntool.principal.com

➤ **Supplemental key employee benefits** (#7 priority)

These are typically targeted to owners and the key employees who are critical to the success of the business.

What we heard — Disability income insurance is the most common (35%) followed by deferred comp-future benefit, retirement protection disability coverage, and executive bonus plans. When looking at what benefits to offer these employees, affordability and ability to attract/retain are key considerations. Compared to last year, more say they're interested in using these benefits to increase productivity.

Planning tip: Principal can help find a plan to fit your business type and overall goals with funding options tailored to your need.



Solutions for your **business**. Protect the future of your business.

💡 **Business protection** (#1 priority)

Helps safeguard the integrity, cash flow, and value of the business if unexpected events like death and disability occur to a key person or business owner.

What we heard — Among business owners who have a plan in place to protect their business, key person life and disability insurance are the most popular. Those with disability overhead expense insurance have more than doubled in the last decade.

Planning tip: Principal can help calculate the value of a key employee and then offer insurance solutions to protect the business due to a death or disability.

💡 **Business succession planning** (#4 priority)

Formal agreements help ensure everyone involved is on the same page when it comes time to transition the business.

What we heard — Almost two-thirds own a family business. The most popular—and growing—succession strategy is to give the business to family members (44%).

Planning tip: Don't forget to consider having the proper funding vehicles—like savings or insurance—to exercise the plan. Consider planning for retirement income sources if your strategy is to give the business to family. The [Business Owner Retirement Analysis](#) from Principal can help.

Solutions for your **lifestyle**. Protect yourself and your family.

💡 **Income protection** (#3 priority)

Helps replace a portion of income and provides continuous cash flow if you're too sick or hurt to work.

What we heard — Ownership of individual disability income insurance is holding steady—43% in 2019 and 45% in 2023.

Planning tip: Individual disability income insurance can provide you with monthly payments when you're too sick or hurt to work. Find out what you need to protect your income and how much it might cost using this simple calculator: principal.com/dicalc.

💡 **Legacy and estate planning** (#9 priority)

When properly funded, these plans and/or agreements can help ensure there are assets—both personal and business—to meet your lifetime objectives.

What we heard — Wills remain the most common wealth transfer strategy (59%), but family trusts, family limited partnerships and irrevocable life insurance trusts are examples of other strategies that continue to be used.

Planning tip: Be sure to review your will and other plans annually to make sure they still accurately reflect how you want your assets distributed.

💡 **Survivor income** (#10 priority)

Life insurance helps provide for your family in the event of death, and can be used to help you achieve other financial objectives.

What we heard — Two-thirds of owners have individual life insurance to help protect their family. And, more than one-third use business assets to help pay for it.

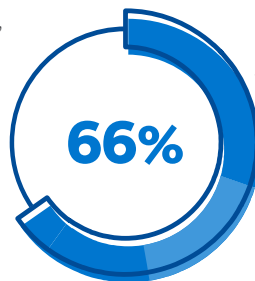
Planning tip: Be sure to consider the type of life insurance you buy — both term and permanent insurance can be helpful to meet your objectives. Find out how much life insurance you need and how much it might cost using this simple calculator: principal.com/lifecalc.



Do you have the right team helping you?

66% of business owners use a financial professional.

Working with a trusted financial professional, CPA, and attorney can provide the complete support you need to move your business forward. Their background and insights can work together to give you a more holistic perspective. Is your team complete? If not, ask one of them for a recommendation.



— 30% look to their financial professional for both business and personal needs.

— 17% go to them for business needs only.

— 19% go to them for personal needs only.

Your goals,
our purpose

No matter what's important to you, Principal® is here to help you identify and implement solutions that are right for your business needs.

What are the next steps?

STEP 1 | **Determine your priorities**

Solutions for your employees

- ☐ Health and wellness solutions
- ☐ Non-medical and voluntary benefits
- ☐ Qualified retirement plans
- ☐ Supplemental key employee benefits

Solutions for your business

- ☐ Business protection
- ☐ Business succession planning

Solutions for your lifestyle

- ☐ Income protection (disability insurance)
- ☐ Survivor income (life insurance)
- ☐ Legacy and estate planning

STEP 2 | **Connect with your team**

Financial professional: _____

CPA: _____

Attorney: _____

Other: _____

Online tools for business and benefit planning

Assess your business needs

Use the Principal® Business Needs Assessment to get your personalized report to explore best practices for helping protect your business, your employees, and your lifestyle.

principal.com/businessneedsassessment

Compare your benefits

See how your benefits compare to what other organizations of your size, industry, and region offer their employees with the Principal® Benefit Design Tool. Are you competitive? benefitdesigntool.principal.com

About the survey

Dynata conducted 1,000 online interviews from January 9 - 20, 2023.

Respondents qualified to take the survey if they met the following criteria:

- United States resident age 21 or older
- Currently employed, either full time, part time or self-employed
- Business owner of at least 5 percent of the company
- Actively manage their business
- Own a company with between two and less than 500 employees

Results are weighted based on the number of employees and annual sales. Potential respondents were selected from those who agreed to participate in Dynata surveys. Because the sample is based on those who agreed to be invited to participate, no estimates of theoretical sampling error can be calculated.



Let's connect

Contact your financial professional or go to principal.com/ownerinsights.



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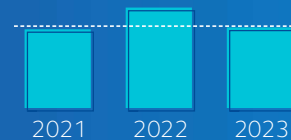
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Importance of benefits for employees and key employees

How do you attract and retain the right talent? Offering benefits shows employees you value them. We asked 1,000 business owners¹ about the importance of benefits for their employees and key employees.

Employee turnover has stabilized.

More than 20% of owners said employee turnover has increased over the past year—compared to 26% one year ago and 20% two years ago.



Offering benefits can help.

The number of owners saying benefits improve recruiting, retention, and productivity has reached record levels.

Benefits help recruit qualified employees.



75% of owners say the employee benefits package helps improve their ability to recruit qualified employees.

Benefits are critical for employee retention.



78% of owners say employee benefits improve retention.

More owners say benefits improve productivity.



71% of owners say employee benefits improve productivity—this percent has grown from 42% in 2015.

Business owners want to offer more employee benefits.



More than 6 in 10 owners want to offer more employee benefits.

When asked how they'd fund additional benefits, 24% would use company profits and 21% say they don't know.

Benefit affordability is critical.

#1

"Affordability of employee benefits" is the #1 concern of owners among various workforce issues.

Key employees

When you think about the success of your business, chances are you have select key employees who play important roles in your organization.

In fact, **98%** of owners report having **at least one key employee**.

More than half want to offer more key employee benefits.



55% of owners want to offer more key employee benefits.

Affordability remains #1 goal of key employee benefits.



The percentage of owners saying affordability is the number one goal has remained steady at 54% again this year.

Businesses are offering key employee benefits at record levels.



87% of owners offer key employee benefits, compared to 74% in 2017.

 Let's connect

Contact your financial professional or go to principal.com/ownerinsights.

¹ 2023 Principal Financial Group® Business Owner Insights survey, conducted by Dynata.



principal.com

The survey was conducted by Dynata and included 1,000 online interviews conducted in January 2023. Results were weighted based on the number of employees and annual sales. Potential respondents for this survey were selected from among those who have agreed to participate in Dynata surveys. Because the sample is based on those who agreed to be invited to participate, no estimates of theoretical sampling error can be calculated.

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Key employee retention
and retirement

Discover the right solutions for your business.

Concepts guide

The right benefits can make all the difference.

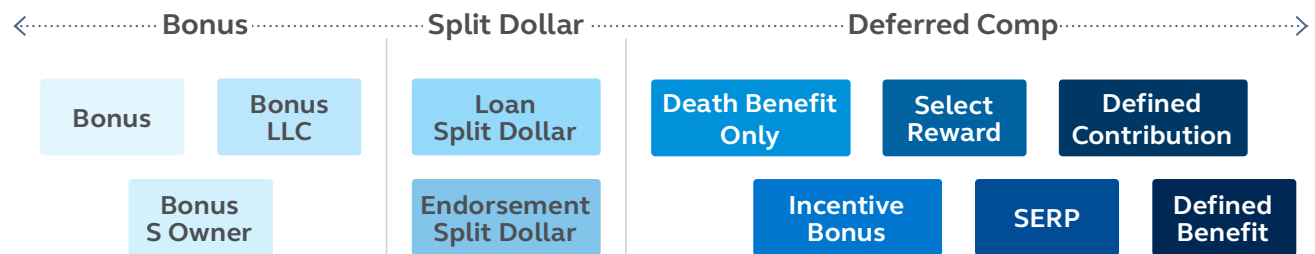


Do you have the right tools to recruit, reward, retain, and retire your key employees?

Key employee benefits can play a big role in helping you keep your top talent for the long term.

No one solution is right for everyone. Sometimes it may take implementing multiple plans to meet the unique needs of one organization. And, your benefits package should reflect that. This guide will give you an overview of some of the options available, and help you find solutions that may be right for your business.

Choose the key employee benefit plans for your business.



Plan highlights

Principal® Bonus

A bonus plan for key employees with an emphasis on simplicity and a current business tax deduction.

Principal® Bonus — S Owner

A bonus plan allowing owners of S corporations to use W-2 compensation or K-1 distributions to enhance their personal retirement. This plan can also help provide favorable taxation at distribution.

Principal® Bonus — LLC Member

A bonus plan allowing members (owners) of limited liability companies (LLCs), taxed as partnerships, to use guaranteed payments or distributions to enhance their personal retirement. This plan can also help provide favorable taxation at distribution.

Principal® Loan Split Dollar

A plan that uses a loan to allow key employees and the employer to share the cost and benefits of the plan. The arrangement between the key employee and employer results in the purchase of a cash value life insurance policy paid with the loans from the employer.

Principal® Endorsement Split Dollar

A plan designed to provide key person death benefits to the business, and death benefit protection for the key employee's family. A life insurance policy is purchased and the premium payments and policy benefits are divided between the two parties.

Principal® Deferred Comp — Death Benefit Only (DBO)

A plan that promises select employees, in the event of their death while covered by the plan, their named beneficiary will receive the benefit specified under the plan. To help fund the liability, the organization could purchase a life insurance policy on the key employee, which could also provide key person coverage.

Principal® Deferred Comp — Incentive Bonus

A long-term incentive plan that gives employers a retention and reward strategy that allows them to provide additional compensation to the select key employees they choose. The company can choose to informally finance the future obligation or pay through company cash flow.

Principal® Deferred Comp — Select Reward

This is a deferred comp defined benefit plan. Enables employers to promise a lump-sum benefit to select key employees payable at the end of a predetermined service period.

Principal® Deferred Comp — SERP

A selective executive retirement plan (SERP) is a deferred comp defined contribution plan to benefit one to five select key employees. Accepts employer contributions only and allows multiple vesting and payout options.

Principal® Deferred Comp — Defined Contribution

A plan allowing select key employees to defer compensation above qualified plan limits—potentially up to 100%.¹ The employer can also provide contributions to help retain employees and meet organizational goals. The company can choose to informally finance the future obligation or pay through company cash flows.

Principal® Deferred Comp — Defined Benefit

A plan providing select key employees a supplemental retirement benefit beyond qualified plan limits. The company can choose to informally finance the future obligation or pay through company cash flow.

Bonus

Key features

- Participants can choose from a variety of products to tailor an investment strategy to meet changing needs and objectives.
- A business solution that's both administratively and tax efficient.
- Available to all employees—no “top hat”² requirements.

Company characteristics

- For employees and owners of C corporations.
- For employees of pass-through entities such as S corporations and LLCs.
- For employees of tax-exempt organizations.
- Companies desiring an immediate tax deduction when funding employee benefits.

Plan sponsor benefits

- Company may submit employee bonuses, as contributions to the plan, and receive a current tax deduction.³
- Requires no discrimination testing or Form 5500 filing.
- Simple, but flexible plan design is easy to communicate and maintain.
- If the plan is financed with life insurance, plan-level administrative services are provided at no cost.
- Since the participant owns the financial product, employers may add a feature to restrict the policy owner's rights in order to add an element of control (i.e., golden handcuffs) to the plan.

Plan participant benefits

- Bonuses may be structured to cover the entire contribution, a portion of it, or provide a “tax bonus” to reduce or eliminate out-of-pocket tax costs to the participant.
- Depending on the asset selected:
- Can build assets outside the business, providing tax-deferred growth.
- Can avoid penalties for distribution before age 59½.
- May provide favorable taxation at distribution.
- Can provide tax diversification.
- Plan participant owns the financial asset.

Considerations

- Bonus must be reasonable compensation (IRC Section 162).
- Each bonus paid reduces company cash flow.
- Restrictive agreement may not be available on all plans, depending on financial asset used.
- Repayment obligation agreement may be available to enhance security.
- Depending on financial asset selected, annual taxation of earnings may apply.
- Limited plan level administrative services available for mutual fund and annuity financed plans.

Bonus – S Owner	Bonus — LLC Member
Key features	
<ul style="list-style-type: none"> • Contributions may come from W-2 compensation or K-1 distributions. • A business solution that's both administratively simple and tax efficient for S corporation owners. • Can provide tax diversification and tax leverage similar to Roth IRAs—without income restrictions or contribution limitations. 	<ul style="list-style-type: none"> • Contributions may come from guaranteed payments or LLC distributions. • A business solution that's both administratively simple and tax efficient for LLC members (owners). • Can provide tax diversification and tax leverage similar to Roth IRAs—without income restrictions or contribution limitations.
Company characteristics	
<ul style="list-style-type: none"> • For owners of S corporations. • Owners offering nonqualified key employee benefits to non-owners who want to benefit themselves as well. • S corporations with accumulated earnings inside the company. 	<ul style="list-style-type: none"> • For members of LLCs taxed as partnerships. • Owners offering nonqualified key employee benefits to non-owners who want to benefit themselves as well. • LLCs with previously taxed income inside the company.
Plan sponsor benefits	
<ul style="list-style-type: none"> • Provides flexibility to choose either W-2 compensation or K-1 distributions. • Provides exemption from annual reporting requirements. • Provides plan-level administrative services at no cost. 	<ul style="list-style-type: none"> • Provides flexibility to choose either guaranteed payments or LLC distributions. • Provides exemption from annual reporting requirements. • Provides plan-level administrative services at no cost.
Plan participant benefits	
<ul style="list-style-type: none"> • Provides liquidity for needs such as retirement income, survivor income, and disability protection. • Depending on the asset selected: • Can build assets outside the business, providing tax-deferred growth. • May avoid penalties for distribution before age 59½. • Provides favorable taxation at distribution. • Provides tax diversification. • S corporation owner owns the financial asset. 	<ul style="list-style-type: none"> • Provides liquidity for needs such as retirement income, survivor income, and disability protection. • Depending on the asset selected: • Can build assets outside of the business, providing tax-deferred growth. • May avoid penalties for distribution before age 59½. • Provides favorable taxation at distribution. • Provides tax diversification. • LLC member owns the financial asset.
Considerations	
<ul style="list-style-type: none"> • Owners receive both W-2 compensation and K-1 distributions (which must be based on their percentage of ownership). Wide variances from year to year may be subject to IRS scrutiny. • Ownership percentages must be considered when using K-1 distributions. If there are multiple owners in the S corporation—and dividends are used to fund contributions—distributions from the corporation need to be in proportion to ownership. • Owners pay tax on W-2 compensation, including payroll taxes such as FICA and Medicare. • Owners pay tax on the K-1 distribution (to the extent there's profit) and don't incur payroll taxes. • Depending on the financial asset selected, asset may be subject to the owner's general creditors, and annual taxation of earnings may apply. 	<ul style="list-style-type: none"> • LLC distributions need to be in proportion to ownership and/or in accordance with the LLC Operating Agreement. • If the contribution is paid out as part of the LLC distribution, profits may be reduced for purposes of distributions made to all members. • Accounting implications may be different depending on whether the LLC uses cash basis or accrual basis accounting, making the client's professional tax advisor involvement important. • Depending on the financial asset selected, asset may be subject to the owner's general creditors, and annual taxation of earnings may apply.

Loan Split Dollar	Endorsement Split Dollar
Key features	
<ul style="list-style-type: none"> • Company can design benefit to recruit, reward, retain, and retire key employees. • Available to all employees, no top hat² requirement. • A portion of the cash value and death benefit equal to the loan is assigned to the employer. At retirement or death, the loan is paid off or forgiven and the assignment is terminated. • Provides enhanced retirement and survivor benefits with minimum employee cash outlay. • Provides cost recovery for employer. 	<ul style="list-style-type: none"> • Endorsement split dollar plans are designed to provide valuable key person death benefits to a business and personal death benefit protection to a key employee's family. • A life insurance policy is purchased and the premium payments and policy benefits are divided between two parties—usually a business and an employee.
Company characteristics	
<ul style="list-style-type: none"> • For employees and owners of C corporations. • For employees of pass-through entities such as S corporations and LLCs. • For employees of tax-exempt organizations. • Companies with employees interested in supplementing income for retirement and providing for family in the event of death. 	<ul style="list-style-type: none"> • For employees and owners of C corporations. • For employees of pass-through entities such as S corporations and LLCs. • For employees of tax-exempt organizations. • Companies with key employees interested in providing for family in the event of their death.
Plan sponsor benefits	
<ul style="list-style-type: none"> • Easy to administer requiring no discrimination testing or Form 5500 filing. • Bonuses to pay the participant's tax on the loan interest are deductible (IRC Section 162(a)1). • Any forgiven loan is tax-deductible (IRC Section 162(a)). • Company has collateral assignment on the policy to secure the loan. • Plan-level and participant-level administrative services provided at no cost. 	<ul style="list-style-type: none"> • Can be an effective method of attracting and retaining valuable key employees. • Employer may have access to the policy's cash value. • Employer can be highly selective regarding which employees are covered.
Plan participant benefits	
<ul style="list-style-type: none"> • Employee owns the policy with minimal income tax impact from premiums paid. • Bonuses may be structured to reduce or eliminate out-of-pocket tax costs to the participant. • No required minimum distribution at age 72. • Cash values in the plan accumulate tax-deferred and can be accessed on a tax-advantaged basis. • Death benefits are received income-tax free by beneficiaries. 	<ul style="list-style-type: none"> • Can provide needed insurance protection at a reduced current out-of-pocket cost. • Can be combined with a cross-purchase buy-sell agreement to even out the current premium costs in the case of a wide age variance among the owners.
Considerations	
<ul style="list-style-type: none"> • Loaned premium isn't deductible. • Interest paid by employees on loans is taxable as income. • Forgiven loans are taxable to the participant. • Life insurance application requires evidence of insurability. • Not available for top executives of public companies. • An exit strategy, defined at plan implementation, is encouraged. 	<ul style="list-style-type: none"> • Split dollar is a method of buying life insurance, not a reason for buying it. A need for life insurance should always exist before a split dollar arrangement is implemented. • The death benefit received from an employer-owned policy at the death of an employee may be income tax-free if the Notice and Consent requirements are met. This requires written notification allowing the employer to purchase a policy on the employee's life.

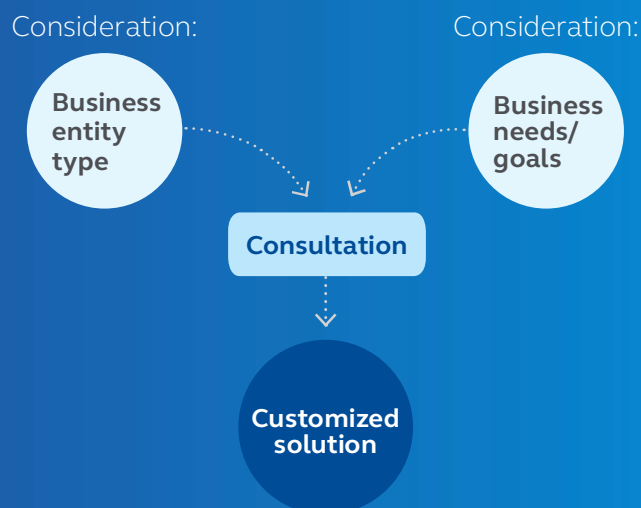
Deferred Comp — Death Benefit Only (DBO)	Deferred Comp — Incentive Bonus
Key features	
<ul style="list-style-type: none"> Both top hat² and employees not considered top hat are eligible to participate in the plan. The plan is flexible and can be tailored to meet specific needs of both the employer and the key employees. Employer selects participants and may vary the benefit for each. 	<ul style="list-style-type: none"> Both top hat² and employees not considered top hat are eligible to participate in the plan. Company can design discretionary incentive benefits to reward and retain selected key employees.
Company characteristics	
<ul style="list-style-type: none"> C corporations (or pass-through tax entity for non-owners). For employees of tax-exempt organizations. Have a substantial business continuity plan in place. Companies with strong financial integrity: profitable, good cash flow and good financial history. 	<ul style="list-style-type: none"> C corporations (or pass-through tax entity for non-owners). Have a substantial business continuity plan in place. Companies with strong financial integrity: profitable, good cash flow and good financial history.
Plan sponsor benefits	
<ul style="list-style-type: none"> Provides an incentive for the key employee to stay for the long term. When the death benefit is paid to the beneficiary, the employer generally receives an income tax deduction. The simple and flexible plan design is easy to communicate and maintain. If the death benefit purchased is higher than the amount promised to key employee(s), the difference can be used to recover the cost of premiums paid, and/or be used for key person protection. If cash value life insurance is used to informally finance the plan, the accumulated value remains an asset on the company's balance sheet. 	<ul style="list-style-type: none"> Easy to administer with no discrimination testing, minimum participation, or Form 5500 filing, if set up properly. Use discretionary company contributions with vesting schedules to help achieve corporate goals. Flexible plan design to meet the needs of specific key employees. Assets accumulated to informally finance the plan remain an asset on the company's balance sheet.
Plan participant benefits	
<ul style="list-style-type: none"> Peace of mind knowing beneficiary(ies) will receive a benefit to help them financially in the event of the key employee's death. Participants don't include the benefit amount as income during their lifetime—so no tax is due. 	<ul style="list-style-type: none"> Pre-tax employer contributions, tax-deferred growth, and compounded earnings. Design a personalized investment strategy. Flexibility to delay plan benefits and the taxation of them if they choose.
Considerations	
<ul style="list-style-type: none"> Employers with more than 100 participants may limit their exposure to certain ERISA requirements if they choose to limit it to top hat employees. The key employee must be healthy enough to qualify for the life insurance policy. The payment of the death benefit will be treated as taxable income to the beneficiaries. Part of the death benefit they receive could be used to pay the tax. 	<ul style="list-style-type: none"> The corporate tax deduction is deferred until benefits are paid, rather than a current deduction.⁴ Distributions to plan participants must be paid within 10 years of the original date of each employer grant. To qualify as a bonus plan not subject to ERISA, the plan cannot be designed to "systematically" provide benefits to participants after separation from service. This determination must be made by the plan sponsor. Plan benefits aren't protected in the event of company bankruptcy. The decision to defer payout of benefits must be made the year prior to when the employer initially contributes to the plan.

Deferred Comp — Select Reward		Deferred Comp — SERP	
Key features			
<ul style="list-style-type: none">Creates an incentive that can tie employees to the business.Design is intended to qualify for the short-term deferral exception to the definition of deferred comp, making it an exception to Section 409A.		<ul style="list-style-type: none">Creates an incentive that can tie key employees to the business.Company can make discretionary incentive contributions to recruit, reward, retain, and retire selected key employees.Subject to 409A.	
Company characteristics			
<ul style="list-style-type: none">C corporations (or for non-owner employees of pass-through tax entities).For employees of tax-exempt organizations.Have a substantial business continuity plan in place.Companies with strong financial integrity: profitable, good cash flow and good financial history.Generally, participants must meet top hat² definition.			
Plan sponsor benefits			
<ul style="list-style-type: none">Easy to administer with no discrimination testing, minimum participation, or Form 5500 filing, if set up properly.Informal financing options include fixed, indexed, or variable universal life insurance policies from Principal.Earnings from company-owned life insurance (COLI) policies accumulate tax-deferred.Company receives a tax deduction (as compensation) if/when the lump-sum benefit is paid.Assets accumulated to informally finance the plan remain an asset on the company's balance sheet.Plan-level administrative services provided at no cost.		<ul style="list-style-type: none">Easy to administer with no discrimination testing, minimum participation, or Form 5500 filing, if set up properly.Informal financing options include fixed, indexed, or variable universal life insurance policies from Principal.Earnings from COLI policies accumulate tax-deferred.Company receives a tax deduction (as compensation) if/ when the benefit is paid out.Vesting schedules and payout options allow plan to meet multiple retention goals.Plan-level administrative services provided at no cost.Life insurance policies used to informally finance the plan remain an asset on the company's balance sheet.	
Plan participant benefits			
<ul style="list-style-type: none">Simple and easy-to-understand plan design.No current income taxation on the promised lump-sum benefit.No required minimum distribution at age 72 or 10% IRS early withdrawal penalty before age 59½.		<ul style="list-style-type: none">Simple and easy-to-understand plan design.Contributions and earnings accumulate tax-deferred.Opportunity to accumulate retirement income in excess of qualified plan limits.No required minimum distribution at age 72 or 10% IRS early withdrawal penalty before age 59½.	
Considerations			
<ul style="list-style-type: none">Participant risks losing the bonus if the service requirement isn't met.Participant must pay economic benefit cost on any death benefit endorsed to them during the service period.Employee must pay income tax on entire lump-sum benefit at payout—no option is available to take an income stream or defer payment of the lump sum benefit.The promised benefit must be paid within 30 days of the participant meeting the service requirement. Failure to do so within 2½ months of the end of the tax year in which the employee meets the service requirement may result in a 20% excise penalty.Not an appropriate benefit for owners or members of the owner's immediate family.		<ul style="list-style-type: none">No loan provisions or rollover provisions into an IRA, qualified plan or nonqualified plan.Limited ERISA protection—assets are owned by the company and subject to company creditors.Participants must provide evidence of insurability to qualify for the life insurance policy used to informally finance the plan.Limited to one to five top hat² employees.The employer tax deduction is deferred until benefits are paid, rather than a current deduction.⁵	

Deferred Comp — Defined Contribution	Deferred Comp — Defined Benefit
Key features	
<ul style="list-style-type: none"> • Company can make discretionary incentive contributions to recruit, reward, retain, and retire selected key employees. • With proper design, may be cost neutral over time or even financially beneficial to the company. • Flexible plan design to meet the needs of specific key employees. 	<ul style="list-style-type: none"> • Company can design discretionary incentive benefits to recruit, reward, retain, and retire selected key employees. • Flexible plan design to meet the needs of specific key employees.
Company characteristics	
<ul style="list-style-type: none"> • C corporations (or pass-through tax entity for non-owners). • Have a substantial business continuity plan in place. • Companies with strong financial integrity: profitable, good cash flow, and good financial history. • Have key employees falling short of savings goals due to qualified plan limits and testing issues. • Participants must meet top hat definition.² 	
Plan sponsor benefits	
<ul style="list-style-type: none"> • Easy to administer with no discrimination testing, minimum participation, or Form 5500 filing, if set up properly. • Make optional company contributions to meet organizational goals. • Supplement 401(k) plan contributions limited by Internal Revenue Code. • Company receives a tax deduction (as compensation) if/when the benefit is paid. • Assets accumulated to informally finance the plan remain an asset on the company's balance sheet. 	<ul style="list-style-type: none"> • Easy to administer with no discrimination testing, minimum participation, or Form 5500 filing, if set up properly. • Increase morale with top employees by offering a benefit they value, which helps keep them loyal and motivated. • Leverage incentives to structure a benefit to recruit, reward, and retain your top employees. • Assets accumulated to informally finance the plan remain an asset on the company's balance sheet.
Plan participant benefits	
<ul style="list-style-type: none"> • Pre-tax deferrals, tax-deferred growth, and compounded earnings.⁶ • Receive benefits beyond 401(k) or 403(b) plan limits. • Defer up to 100%¹ of compensation to meet savings goals. • Design a personalized investment strategy. • Flexibility to take payouts from the plan without the restrictions that apply to 401(k) plans. 	<ul style="list-style-type: none"> • Receive an additional benefit paid entirely by the employer without any investment risk by the employee. • Receive benefits beyond 401(k) or 403(b) plan limits. • Design a personalized investment strategy. • Flexibility to take payouts from the plan without the restrictions that apply to 401(k) plans.
Considerations	
<ul style="list-style-type: none"> • Plan benefits aren't protected in the event of company bankruptcy. • If the company doesn't comply with IRS rules, participants could face taxes and penalties. • There are no rollovers or loans like qualified retirement plans. • The corporate tax deduction is deferred until benefits are paid, rather than a current deduction.⁴ • The decision to defer compensation must be made the year ahead of earning the income. • There are fees for plan administrative services and could be a potential charge to earnings on assets purchased to finance the plan. 	<ul style="list-style-type: none"> • Plan benefits aren't protected in the event of company bankruptcy. • If the company doesn't comply with IRS rules, participants could face taxes and penalties. • The corporate tax deduction is deferred until benefits are paid, rather than a current deduction.⁴ • There are fees for plan administrative services and could be a potential charge to earnings on assets purchased to finance the plan. • The company takes an investment risk by promising to pay a defined benefit to the employee.

We're here to help.

There's a lot to think about when you're designing and implementing a benefits package. And while the plan is a core part of your key employee benefits solution, there's so much more to consider. Think about the entire package—**solutions**, **expertise**, and **service**.



Solutions

You'll want a benefits package that fits your business type and overall goals. Principal offers multiple, unique solutions for all types of businesses.

Expertise

When implementing a new plan, it's helpful to work with a provider that has the expertise and experience to understand how to turn your objectives into a successful benefits package. Our team of business solutions experts will consult with you and your financial professional to determine the right solution for your organization.

Service

We know you need to spend your time focusing on your business. That's why we focus on the details so you don't have to. Our plan administrative services staff assist you with the day-to-day aspects of your plan.



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- A member of the FORTUNE 500®, we have \$714 billion in total assets under management⁷ and serve clients worldwide of all income and portfolio sizes.
- Year after year we receive strong financial ratings from the four major rating agencies—A.M. Best Company, Moody's Investor Services, Standard & Poor's, and Fitch Ratings.⁸
- No. 1 provider of nonqualified deferred compensation plans.⁹
- We're the leader in the small-case business life insurance market.¹⁰

¹ Employees can defer up to 100% of compensation, but plan sponsors typically permit deferrals of less than 100% due to other payroll deductions, such as FICA taxes and health insurance.

² "Top hat" employees are a select group of management or highly compensated employees that meet Department of Labor guidelines.

³ Depending on the plan type and options selected, the tax-deductible amount will differ.

⁴ For taxable corporations.

⁵ Contributions to the plan are subject to FICA when benefits vest. Distributions are taxable to plan participants upon receipt.

⁶ Contributions to the plan are subject to FICA when benefits vest. Plan participant deferrals may not be deductible in all states. Distributions are taxable to plan participant upon receipt.

⁷ Principal® 2022 Company Profile. Data for the trailing 12 months ended December 31, 2021. For the latest and additional information, visit [principal.com](https://www.principal.com).

⁸ Third-party ratings relate only to Principal Life Insurance Company, the largest member company of the Principal Financial Group, and Principal National Life Insurance Company, and do not reflect any ratings actions or notices relating to the US life insurance sector generally. While ratings can be objective indicators of an insurance company's financial strength and can provide a relative measure to help select among insurance companies, they are not guarantees of the future financial strength and/or claims-paying ability of a company and do not apply to any underlying variable investment options. The broker/dealer a life insurance policy is purchased from, the insurance agency and any representations regarding the quality of the analysis conducted by the rating agencies. The above mentioned entities are not affiliated with any rating agency nor are they involved in any rating agency's analysis of the insurance companies.

⁹ Based on total number of Section 409A plans, PLANSPONSOR Recordkeeping Survey, July 2021.

¹⁰ July 2021 COLI/CSIO survey of participating life insurance carriers, IBIS Associates, Hamilton, VA.

Your goals, our purpose

No matter what's important to you, your financial professional and Principal are here to help you identify and implement solutions that are right for you, your business, and your employees. We've been administering business cases for more than 30 years, and make it a priority to understand where you want to be and how you plan to get there. This means you'll get expertise and innovative ideas when you need them to help make your financial progress possible.

Let's connect

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Key employee retirement benefits

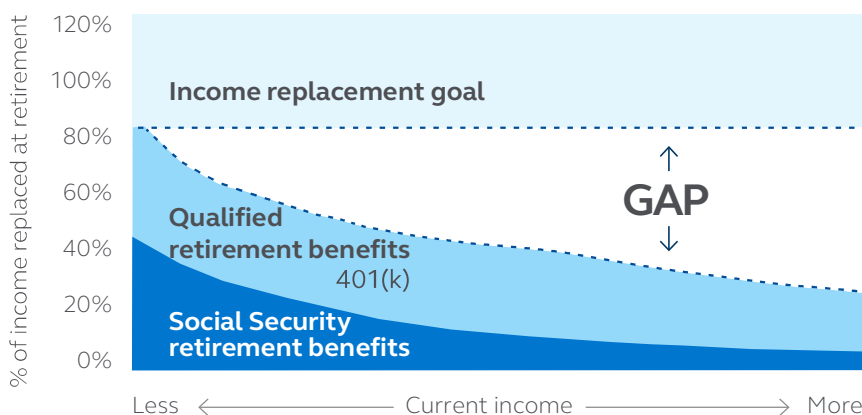
Help your top talent avoid an income gap

Typical retirement sources might not be enough for your key employees. And you can help.



You've likely heard experts say that people need about 80% of their pre-retirement income to maintain their standard of living in retirement. Are your key employees on track to hit that mark?

The chart below shows the estimated percentage of income that will be replaced at retirement from Social Security and qualified plan benefits, such as a 401(k) plan. You'll see that as income goes up, the percentage of benefits expected from qualified plans and Social Security goes down, creating an income gap. This gap could be filled using a nonqualified key employee benefit plan from Principal®, which complements other retirement income sources.



This information is from the Principal Financial Group® Replacement Ratio Calculator with source information from the Annual Statistical Supplements to the Social Security Bulletin (www.ssa.gov). It is intended to demonstrate the potential impact of Social Security and 401(k) plan benefits at various income levels. For more information on your individual circumstances, please speak with your financial or tax professional. ©2022 Principal Financial Services, Inc.

Reasons for an income gap

Qualified 401(k) plans and individual retirement accounts (IRAs) have limits to how much you can contribute each year. Plus, qualified plans may be subject to coverage and non-discrimination testing that can limit the amount of employee and employer contributions to the plan.

For 2023, here are the savings limits for different retirement plans:

401(k) retirement plans:

- \$150,000 of wages earned in the preceding year classifies an employee as highly compensated.
- 1.25%/2% nondiscrimination limit (sometimes called ADP or 401(k) testing limit).
- \$22,500 maximum deferral (\$30,000 if age 50 or older).
- \$330,000 maximum eligible compensation limit.
- 10% additional tax for early withdrawals.

Defined contribution (profit sharing) retirement plan:

- Total amount of company and employee contributions equal to the lesser of 100% of compensation or \$66,000.
- \$330,000 maximum eligible compensation limit.
- 10% additional tax for early withdrawals.

Defined benefit (pension) retirement plan:

- \$265,000 maximum annual benefit.
- \$330,000 maximum eligible compensation limit.

Individual retirement account (IRA):

- Employees with modified adjusted gross income above certain amounts (depending on filing status) cannot deduct contributions to an IRA account if participating in a qualified retirement plan.
 - \$6,500 maximum contribution (\$7,500 if age 50 or older).
- 10% additional tax for early withdrawals.
- No Roth IRA contributions may be made if the individual's modified Adjusted Gross Income (AGI) is in excess of \$228,000 (married) or \$153,000 (single).

Your key employees need a way of saving more for retirement—you can help them do just that!

 [Learn more](#)

Contact your financial professional today.



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TAXATION OF EMPLOYER OWNED LIFE INSURANCE

TAXATION OF DEATH BENEFITS TO THE BUSINESS

When a business receives the death benefit from an Employer-owned life insurance policy, the IRS allows them to exclude from income the amount of premiums and amounts paid into the policy.⁴ The remaining amount of the death benefit received is reported as income to the business. Exceptions to this IRS inclusion rule could allow the entire death benefit proceeds to be free of income tax to the business, once the business satisfies the notice and consent requirements, and any one of the following:

1. Exception for a recent employee: The insured was an employee of the employer at any time during the 12-month period before the insured's death.⁵
2. Exception for a director or highly compensated employee or individual at the time the policy was issued. This would include:⁶
 - A director
 - A 5%-or-greater owner of the business at any time during the current year or the preceding year
 - A highly compensated employee or highly compensated individual with compensation of at least \$130,000 for 2021 (adjusted annually for cost-of-living)
 - One of the five highest-paid officers
 - Among the highest-paid 35% of all employees
3. Exception for death proceeds paid to heirs: The death proceeds are paid to:⁷
 - A member of the insured's family, which includes brothers and sisters (also half-brothers and half-sisters), spouse, ancestors, and lineal descendants
 - Any individual who is the designated beneficiary of the insured under the contract (other than the employer)
 - A trust established for any family member or designated beneficiary, as just described
 - The estate of the insured
4. Exception for death benefit proceeds being used to purchase an equity interest in the business (employer) by any family member, beneficiary, trust, or estate.⁸



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ANNUAL FILING REQUIREMENTS

Employers that own life insurance on their employees also must comply with the ongoing requirement outlined in IRC § 6039I, which requires an annual report of EOLI contracts. Reporting is accomplished by attaching IRS Form 8925 to the employer's income tax return for the year.

The employer must report the following to the IRS annually:

- The total number of employees under the employer at the end of the tax year
- The number of those employees insured under employer-owned life insurance contracts at the end of the tax year for policies issued after August 17, 2006
- The total amount of insurance in force at the end of the tax year under those contracts
- The name, address, and taxpayer identification number of the employer, and the type of business in which the employer is engaged
- Verification that the employer has a valid consent for each insured employee, or, if all required consents are not obtained, the number of insured employees for whom consent was not obtained

Employers are required to keep records that show the requirements of both IRC § 101(j) and 6039I are met for all applicable tax years by filing IRS Form 8925, "Report of Employer-Owned Life Insurance Contracts."

NOTICE AND CONSENT

There are three components to the notice and consent requirement that must be met before the policy is issued:

1. Notify the employee in writing that the employer intends to insure the employee's life. The notice must state the maximum face amount for which the employee could be insured and must be either in dollars or as a multiple of salary.
2. Obtain the employee's written consent to being insured under the policy.
3. Inform the employee in writing that the employer will be directly or indirectly a beneficiary of any proceeds payable on the employee's death.

An inadvertent failure to satisfy the notice and consent requirements may be corrected under the following circumstances:⁹

1. The applicable policyholder (business/employer) made a good faith effort to satisfy those requirements.
2. The failure was inadvertent.
3. The failure was discovered and corrected no later than the due date of the tax return for the taxable year of the applicable policyholder (business/employer) in which the policy was issued.

⁴ IRC §101(j)(1)

⁵ IRC §101(j)(2)(A)(i)

⁶ IRC §101(j)(2)(A)(ii)

⁷ IRC §101(j)(2)(B)(i)

⁸ IRC §101(j)(2)(B)(ii)

⁹ IRS Notice 2009-48, Q-13 & A-13

SAMPLE NOTICE OF CONSENT

EMPLOYER INTENT TO INSURE EMPLOYEE'S LIFE

_____ ("Employee") is being notified by

_____ ("Employer") under Internal Revenue
Code § 101 (j) that:

- A. Employer intends to apply for insurance on Employee's life;
- B. The maximum face amount at the time the policy is issued on the life of the Employee shall not exceed \$ _____ ; and
- C. Employer shall be a direct or indirect beneficiary of life insurance proceeds payable upon death of Employee.

EMPLOYEE CONSENT TO BEING INSURED

Employee acknowledges receipt of this notice and agrees to:

- A. Consent to being insured by Employer;
- B. Consent to the policy being continued following any termination of employment with Employer; and
- C. Consent to employer being a direct or indirect beneficiary of any life insurance proceeds payable.

Employee

Date



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LIVING BENEFIT BUY-SELL AGREEMENT

Protect the Future of Your Business



You've worked hard to build your business. How can you ensure that your business lasts well into the future?

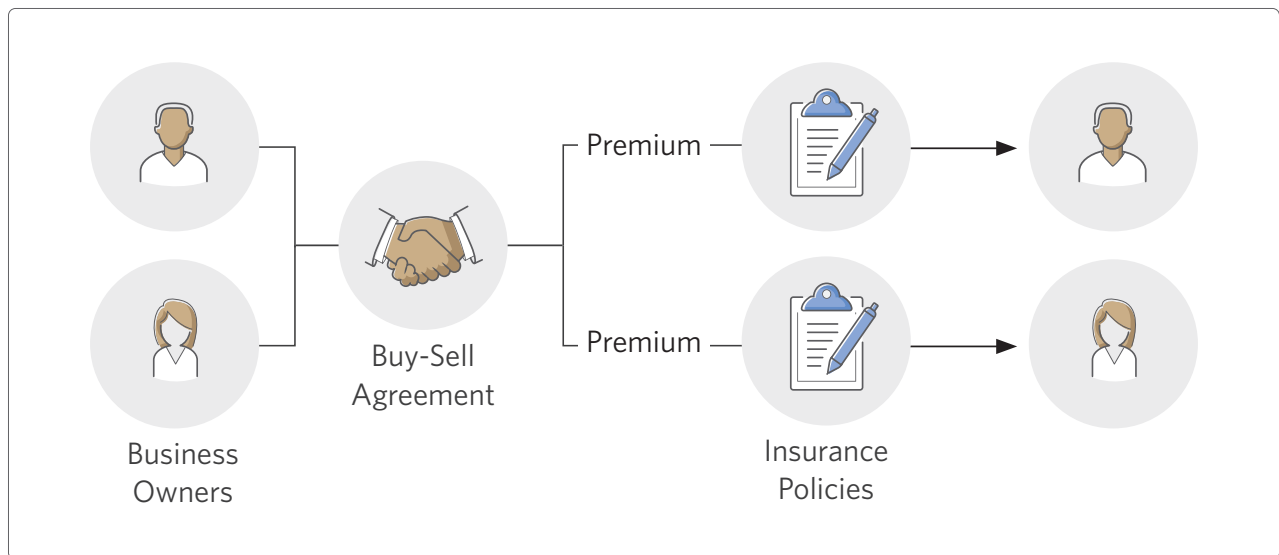
Owning a business can be one of the most rewarding experiences in our lives. To build something from the ground up with hard work and passion that can be passed from one generation to the next can be a dream come true for many entrepreneurs. But if you own that business with a partner, it's vital that you consider what will happen to that business when one of you passes away.

That's exactly what a buy-sell agreement is for. It takes the uncertainty out of the equation and helps you rest easy, knowing the business you've built will survive beyond the death of a partner.

But because there are many kinds of businesses and relationships between owners, there are a few different kinds of buy-sell agreements. One of them is a Living Benefit Buy-Sell Agreement. It lets business owners prepare for the best-case scenario, while still preparing for the worst.

How does a Living Benefit Buy-Sell Agreement work?

- 1 The business owners enter into a written buy-sell agreement committing to sell their interest and buy the interest of the other owner(s).
- 2 You and the other business owners own and are the insured on an individual life insurance policy. Each owner collaterally assigns some (or all) of the death benefit to the other owner(s) or names the other owner(s) as irrevocable beneficiary in a sufficient amount that allows the other owner to buy the business interest. The remaining death benefit can go to family or other beneficiaries.
NOTE: If the buy-sell is designed to cover owners of a corporation, their assignment or irrevocable beneficiary will be to the corporation.
- 3 Doing so creates an economic benefit for each owner equal to the cost of basic coverage in the amount of the assigned portion of the death benefit (as defined in IRS Table 2001). Each owner recognizes that amount as taxable income.
- 4 As owner of their own policy, each business owner is free to fund the life insurance policy in whatever amount is desired to build a cash value that the owner can use, subject to any restrictions in the buy-sell agreement. The owner can use that cash to supplement his or her individual retirement, buy out retiring or departing co-owners, handle family expenses such as tuition, or any other purpose not limited by the buy-sell agreement.
- 5 Most business owners retire from their business, so it's good to be prepared for your co-owner's retirement as well as having financial protection against an owner's death. This form of buy-sell allows flexibility to provide for those possibilities.



Benefits of a Living Benefit Buy-Sell Agreement

- Personal ownership of your policy — you name the beneficiary and control the cash value. Any death benefit not committed to the buy-sell agreement can go to family or other personal beneficiaries
- Younger and healthier owners aren't required to pay premiums on older and less healthy business partners as they might be with a cross purchase buy-sell agreement
- You can fund your own policy at a higher level to build greater cash value for your future use
- Policy is portable — if the business ends or you retire, you still retain the policy and any cash value
- As an individually owned policy, it may be protected against business creditors
- The business owners can prepare for the best while protecting themselves and their business against the worst



A Living Benefit Buy-Sell Agreement allows you to plan and protect the future of your business on your own terms. Talk with your financial advisor about how this agreement might work for you.



Why Mutual of Omaha

Over 50 years of Mutual of Omaha's Wild Kingdom taught us that the animal kingdom and the human kingdom have something in common ... an instinct to protect what matters most. Through insurance and financial products, we help people protect their lives, protect their families, protect their kingdoms.

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This material illustrates a concept. Direct specific tax or legal questions to your tax or legal counsel.

Business Planning Strategies

Using the Cash Surrender Value on an Indexed Universal Life Policy



Life insurance can be an important planning tool for business owners. The cash surrender value of an Indexed Universal Life (IUL) policy provides flexible options for business owners who are planning for the future of their company. And the Guaranteed Refund Option (GRO) rider¹ on a fully-underwritten IUL policy provides the business owner with an additional layer of protection.

Here are three scenarios in which the cash surrender value can benefit your business clients:

Key Person Insurance

The loss of a key employee's skills can put a business at serious financial risk. Life insurance plays an important role in protecting a business if the key employee dies unexpectedly.

But, what happens if the employee chooses to leave? With an IUL policy, the business owner has the option to surrender the policy for its cash surrender value.

Cross-Purchase Buy-Sell Arrangements

With a cross-purchase buy-sell, an owner can purchase a deceased owner's share of the business at a previously agreed upon price. When using life insurance to fund the buy-sell agreement, each participating owner purchases a life insurance policy on the other owner's life. At the first owner's death, the other owner uses the life insurance proceeds to purchase the deceased owner's share of the business.

But, what happens after the first owner dies? The remaining policy may no longer be needed. The executor of the estate that holds the other policy can always choose to keep the policy. By using a policy with an accumulation value, like an IUL policy, the business owner has the option to surrender the policy for its cash surrender value.

Business Succession Planning

When a younger person plans to purchase the business from an older owner, oftentimes, there is a buyout plan that is structured using life insurance. The future owner purchases a life insurance policy on the current owner and when the owner dies, the policy proceeds are used to fund the business buyout.

As the business owner gets older, they may reach a point where they want the buyout to occur while they are still living. When using an IUL policy, the person who intends to buy the business has an option to surrender the policy for its cash surrender value. This money could be used toward the purchase of the business.

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For Life Protection Advantage, the GRO rider is not available for clients over age 60 (regardless of risk class), for substandard or tobacco cases under age 50 or for substandard tables 5-16 at ages 50 and above. For Income Advantage, the GRO rider is not available for substandard or tobacco cases under age 50 or for substandard tables 5-16 at ages 50 and above. In order to remain eligible for the rider, the client must continue to make their required premium payments as defined in the rider. Refund is limited to 80% of the policy's lowest specified amount and is reduced by any previous withdrawals and outstanding loans.

The GRO Guarantee

It's important to point out that an IUL policy's cash surrender value is not guaranteed. So, what happens if the cash surrender value does not exceed the total premiums paid? That's where the Guaranteed Refund Option rider comes in. All qualifying Income Advantage IUL and Life Protection Advantage IUL policies come with this feature at no additional charge.¹ The GRO rider provides seven 60-day windows in which the policyowner can surrender their policy and receive their paid premiums back – up to 50 percent at the end of year 15 and up to 100 percent at the end of years 20, 21, 22, 23, 24 and 25.

Give me a call on your next business case to see how an IUL policy can provide additional value for your client.

How prepared are you to exit your business?

You have a lot to consider when planning to successfully transition out of your business—like preparing a plan, determining a value for the business, and how you'll fund your plan. It's also important to consider: **Is your business your retirement? Are you and your business ready for what comes next? How does your progress stack up to that of other business owners?** We asked a group of owners recently about their plans¹, and though some have plans in place, many still don't.

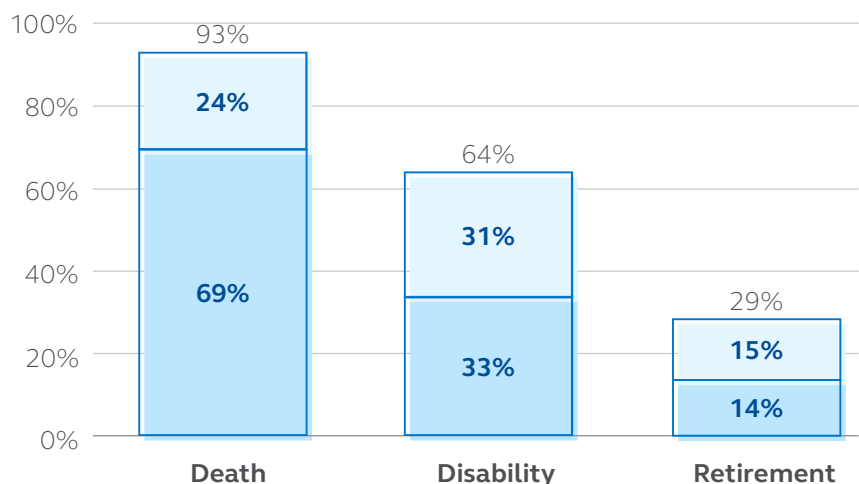
Top transition events

Most buy-sell agreements account for transitioning at death but leave disability and retirement often overlooked. **Planning for these events will help ensure successful transition of your business.**

Percentages of business owner agreements that cover these **top transition events** and whether they're **mandatory or optional**.

- Optional triggering events
- Mandatory triggering events

Source: Review of 2,368 buy-sell agreements by Principal Financial Group®, January 1, 2014 - June 30, 2022.



Have you started thinking about retirement?

Today, you may think you're going to work forever. But as the years go by, your plans might change.

Only 14% of business owners don't ever expect to retire. This statistic has dropped significantly since the first survey in 2010 when 31% said they don't plan to retire. Knowing how your business fits into your retirement is more reason to ensure you have proper planning in place.

¹ 2023 Principal Financial Group Business Owner Insights survey, conducted by Dynata. principal.com/ownerinsights

If you're within 10-20 years of retirement



Now's the time to determine the value of your business so that it can eventually help to fund your retirement. Here are some of the steps other business owners have taken to start the planning process:

Create a business succession plan



61% of owners have a business succession plan.



Of those who have a plan, **95%** are either somewhat or very confident about their exit strategy. Their reasons for being confident include knowing they have a good plan, a strong business, and family will take over.

Review your business succession plan



Of the owners with plans, **79% had them reviewed** in the past two years.



The most popular—and growing—succession strategy is giving the business to family members. Forty-four percent of owners said this was their plan. If family succession is your plan, do you know how you'll replace your income without a buyout for the business?

If you haven't started planning or still have some planning to do, we can help! Complimentary services from Principal offer a great starting point. **Ask your financial professional** about requesting an **Informal Business Valuation** and/or a **Buy-Sell Agreement Review**.



principal.com

The survey was conducted by Dynata and included 1,000 online interviews conducted in January 2023. Results were weighted based on the number of employees and annual sales. Potential respondents for this survey were selected from among those who have agreed to participate in Dynata surveys. Because the sample is based on those who agreed to be invited to participate, no estimates of theoretical sampling error can be calculated.

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