

CRESCENT WEALTH ADVISORY

BUSINESS OWNER PLAYBOOK



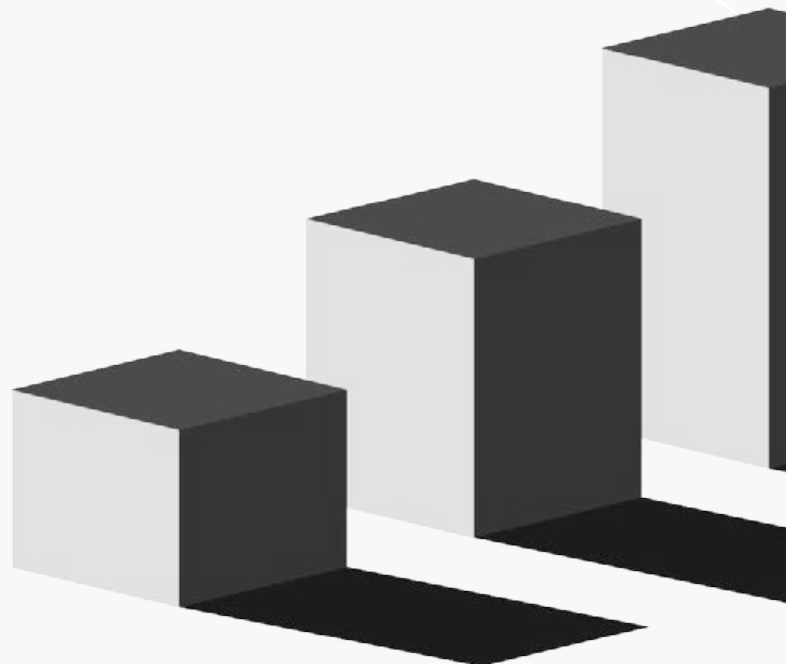
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PRIVATE CLIENT GROUP

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Business Owner Solutions Decision Tree

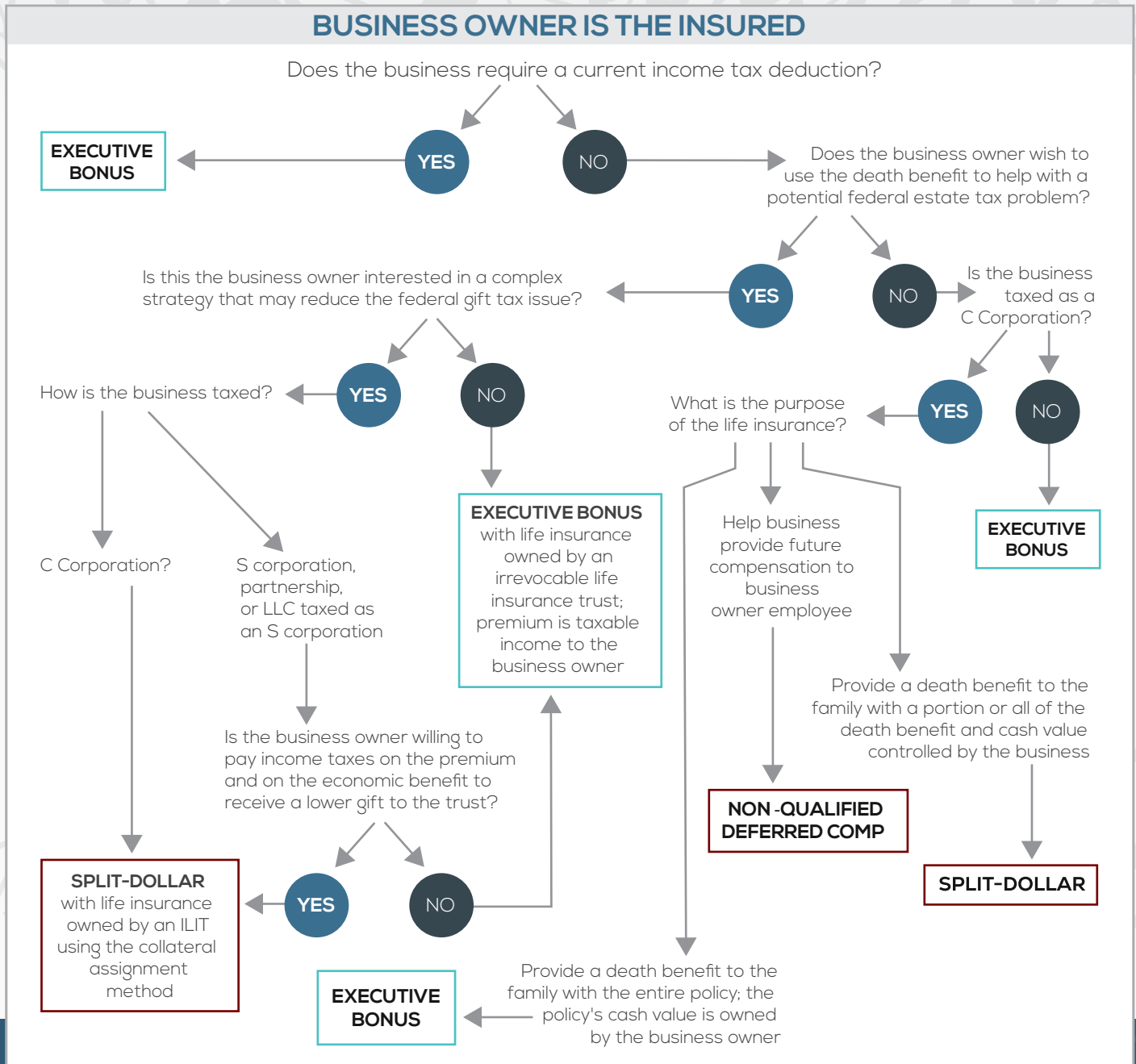
Solutions for small businesses

Financial strategies including life insurance is about financially safeguarding your client's business.

Business owner life insurance can be coverage for debt protection, earmarked for income replacement, a tool to retain key employees, and a great way to keep a company afloat in good times and bad.

With current market volatility, it may be time to talk Split-Dollar, Executive Bonus, or Non-Qualified Deferred Compensation with clients.

This decision tree can help you determine if one or more of these strategies makes sense as an avenue for the business owner to supplement their personal financial needs.



Keep in mind that the decision tree is meant only as a guide when business-owner clients are purchasing life insurance. Every case is different, and there may be special circumstances that require deeper analysis of the various strategies available. Your clients should also consult with their tax and legal advisors to determine if any of the strategies referenced are appropriate for them.

Business Owner Solutions Decision Tree

Solutions for small businesses

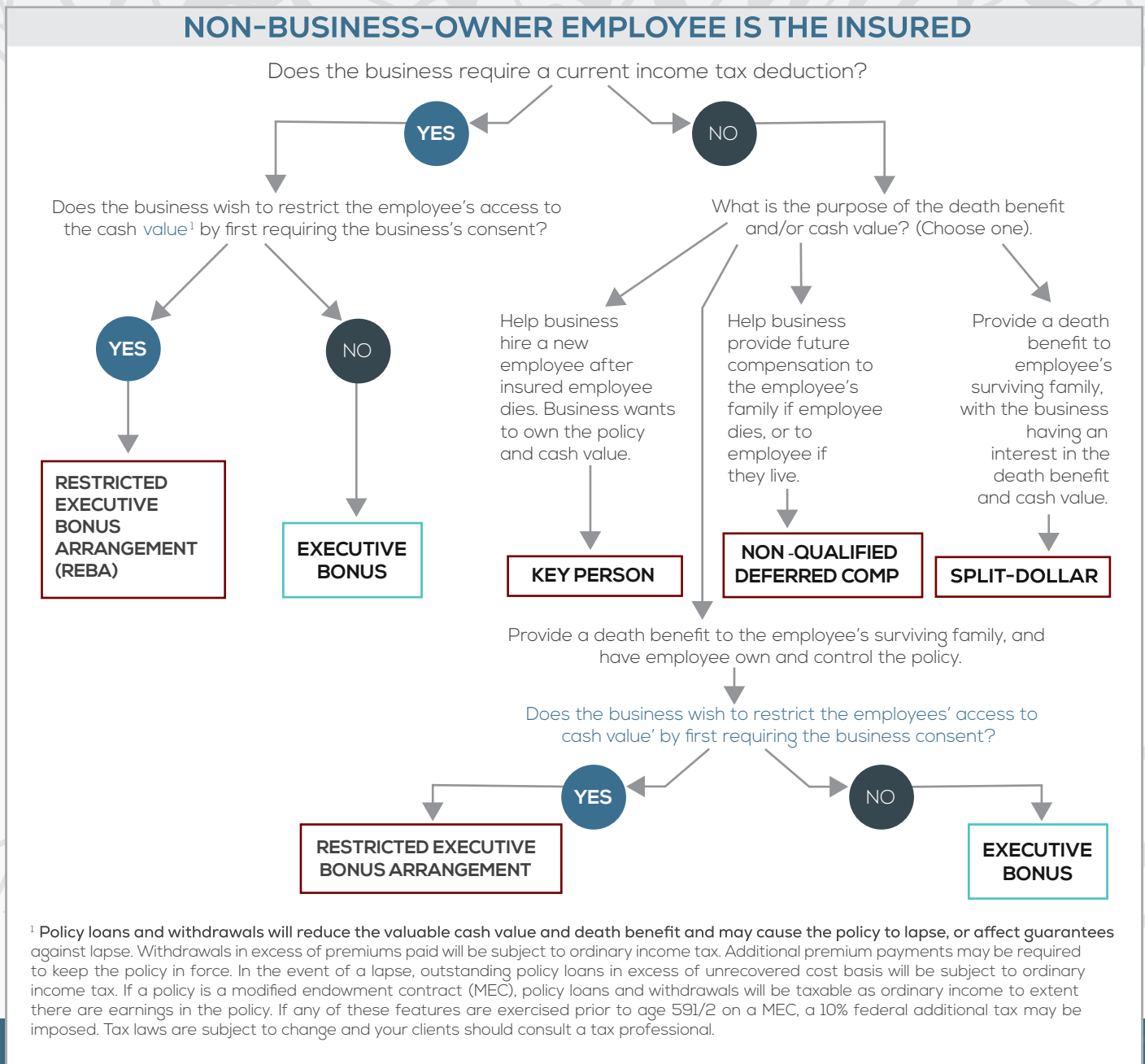
Financial strategies including life insurance is about financially safeguarding your client's business.

Most businesses have at least one key employee that's crucial to the success of the company, so taking out coverage on them for potential business losses helps safeguard the business in the case of disability or untimely death.

If the business decides to fund a personal life insurance policy as a special benefit, it may be time to talk Key Person,

Executive Bonus, Split-Dollar, or Non-Qualified Deferred Compensation.

The following decision tree can help you determine if one or more of these strategies makes sense for a business and its key employee.



Keep in mind that the decision tree is meant only as a guide when business-owner clients are purchasing life insurance. Every case is different, and there may be special circumstances that require deeper analysis of the various strategies available. Your clients should also consult with their tax and legal advisors to determine if any of the strategies referenced are appropriate for them.

KEY PERSON COVERAGE

Protecting the business against the “what-if.”

CONCEPT DESCRIPTION

The loss of a key employee can affect a business in many ways. It can affect the efficiency of day-to-day functions, the revenue and growth of the company, and even the value someone’s willing to pay to buy the business. Protecting against the “what-if” and purchasing life insurance on the key employee(s) is something business owners should consider to protect the bottom line of their business.

Purchasing a life insurance policy on a key employee and having the company be the owner and pay the premiums allows the business to receive the death benefit tax-free. The death benefit can help offset costs associated with finding and training a replacement, lost revenue, or increased expenses. Term or permanent life insurance can be used in this strategy.

CLIENT PROFILE

Small business identifies a key executive or employee at a company and desires to protect the business from the losses they may incur if something happens to that key employee. The business has the potential to be sold in the future and wants to show they have protections in place in case a key employee dies.

Key Selling Points

- Death benefit is received tax-free by the business as long as IRS Sec 101(j) requirements are met and the employee consents to the company buying life insurance on them
- Premiums aren’t tax-deductible to the business
- Remarkably easy to implement and maintain
- The amount of insurance should be equal to the estimated lost revenue and additional expenses associated with the premature death of the key employee

CASE STUDY

Rita is the sole owner of XYZ, Inc. and worries about what would happen to her small business if her key employee, Susan, prematurely dies. Susan is instrumental in the sales generated by XYZ, Inc. and the business’s day-to-day functions. Susan has been there for almost 20 years, and Rita would have difficulty finding and training someone to replace Susan.

Rita can protect her business by purchasing a life insurance policy on Susan’s life in the amount she expects it would cost her to replace the job functions and value Susan brings to the business. The business would own the policy, pay the premiums, and get consent from Susan before the life insurance is purchased. Rita finds relief knowing that her business has resources available to recover from the unexpected passing of Susan.



CLIENT COMMENTS TO WATCH FOR

“I have an employee that’s vital to my business, and I don’t know how I’d replace them if they passed away.”

“I’m thinking about selling my business in a few years and want to think about ways to protect the value of my business to make it attractive to potential buyers. What are some things I should be thinking about?”

“I don’t know what we’d do without [key employee name]. They’re vital to my business.”

RIGHT QUESTIONS TO ASK

“Would you want to hear about a simple way to protect your business from the effects a premature key employee death could have?”

“Is there anyone that works for you who would be very hard to replace?”

“Are you looking to sell your business in the future? What are you doing to make your business stand out from others?”

EXECUTIVE BONUS ARRANGEMENT

The simplest plan for a business owner to reward their top talent.

CONCEPT DESCRIPTION

Executive bonus agreements are the simplest form of employee benefit to establish and implement. Businesses are getting creative and implementing strategies to help attract and retain their top talent, and an Executive Bonus Plan can be an effective way to do just that.

A key employee applies for and purchases a life insurance policy and the employer pays the premium in the form of an employee benefit. The employee has access to the insurance policy's cash value, and the policy is entirely portable. There are no restrictions that can act as a golden handcuff.

If a business would like to restrict the access the employee has to the policy and the cash value until specific triggers are met, then a Restricted Executive Bonus Arrangement may be a better solution. The business's premium contributions on behalf of the employee are considered a bonus. And it'll be taxed as income to the employee and deductible to the business.

Some businesses will elect to pay a "double bonus" that includes the bonus for the life insurance policy premium and the estimated income tax on the initial bonus.

CLIENT PROFILE

A small business that identifies a key executive or employee and wishes to provide a reward for exceptional service and to entice them to stay with their company. The business is willing to pay a bonus to the employee in the form of a life insurance premium to provide an additional employee benefit.

Key Selling Points

- Employer can deduct bonus payments under IRC Section 162 provided the total amount of compensation is reasonable
- Employee owes ordinary income taxes on the bonus contributions at the time they're given
- Employee has control of the policy and its cash value as well as the ability to designate beneficiaries
- Death benefit is paid income-tax-free to the employee's beneficiary
- Straightforward and easy to implement and maintain
- "Double bonus" may be attractive to employee where employer bonuses both the income tax due to the employee and the policy premium
 - **Example:** 30% tax bracket, a \$17,143 bonus nets \$12,000 annual premium to the policy



CASE STUDY

Jim is the sole owner of ABC, Inc. and wants to offer something special to his leading salesperson, Jenna. He wants to reward Jenna for her dedication and hard work.

Jim can set up an Executive Bonus Plan for Jenna, and the bonus paid by ABC, Inc. is deductible. Jim would also not want Jenna to incur any taxable expenses. He then chooses to “double bonus” Jenna to cover the income tax due on the life insurance policy premiums.

The life insurance policy is designed to be max-funded during 10 years by ABC, Inc. and is projected to provide Jenna a substantial death benefit for her family or an income stream in retirement that she otherwise wouldn't have.

CLIENT COMMENTS TO WATCH FOR

“I'm really worried about one of my key employees leaving; it'd be very hard to recover from.”

“I hear about companies doing all kinds of creative things these days for their employees. Is there something I can do for certain employees to reward them?”

“I wish there was a bonus I could pay certain employees that was easy to implement.”

RIGHT QUESTIONS TO ASK

“Would you be interested in providing a bonus arrangement to employees you can't afford to lose that provides them a meaningful benefit?”

“Would you want to hear about what some other companies are doing to keep their key employees in this crazy job market?”

RESTRICTED EXECUTIVE BONUS ARRANGEMENT (REBA)

A top concern of business owners today is retaining their top talent.

CONCEPT DESCRIPTION

One of the most significant risks in today's job market to a successful business is losing a key employee. Companies are getting creative and implementing strategies to help retain their top talent, and a Restrictive Executive Bonus Arrangement (REBA) can do just that.

Like a traditional bonus arrangement, an employer pays the premium on a life insurance policy owned by the key employee and insuring his or her life in the form of an employee benefit. The difference is that with a REBA bonus plan, the employee's cash value access to the insurance policy is limited until specific triggers are met. Triggers can be the passage of a certain amount of time, retirement, or other considerations.

These restrictions can act as a golden handcuff to help a business recruit, retain, and reward top talent in its industry. Except for the limitation on access to the cash value, the policy is owned and controlled by the employee.

CLIENT PROFILE

Ideal clients for the REBA strategy are employers with key executives or employees at a business that wish to provide an employee incentive to stay with their company. The business or decision-maker is willing to pay a bonus to an employee in the form of a life insurance premium and desires a vesting or restriction period that the employee must stay with the company before they can access the cash value.

Key Selling Points

- The employer can deduct bonus payments under IRC Section 162 provided the total amount of compensation is reasonable (employee will owe ordinary income taxes on the bonus contributions at the time they're given)
- A separate restrictive agreement prevents an employee from accessing the cash value of the policy, thus creating an incentive for them to stay with the company until a triggering event
- The employee has control to designate beneficiaries, and death benefits are paid income-tax-free to employee's beneficiary
- Very straightforward and easy to implement and maintain
- "Double bonus" may be attractive—where the employer bonuses both the income tax due and the policy premium to the employee
 - **Example:** 30% tax bracket, a \$17,143 bonus nets \$12,000 annual premium to the policy



CASE STUDY

Jim is the sole owner of ABC, Inc. and wants to offer something special to his leading salesperson, Jenna. He wants to reward Jenna for her dedication and hard work while protecting her from being poached by his competition.

Jim can set up a REBA for Jenna, and the bonus paid by ABC is deductible. Jim would like for Jenna to not incur any taxable expenses as well. Jim can then “double bonus” Jenna to cover the income tax due from her on the life insurance policy premiums. He can also put a restrictive agreement around Jenna’s access to the cash value in the policy.

Jim and Jenna agree that for the next ten years, Jenna won’t have access to the cash value but can designate the beneficiary and own the life insurance policy herself. The policy is designed to be max funded during those ten years by ABC, Inc. It’s projected to provide Jenna with a substantial death benefit for her family or an income stream in retirement that she otherwise wouldn’t have.

CLIENT COMMENTS TO WATCH FOR

“I’m really worried; it’d be very hard for me to recover if one of my key employees left.”

“I hear about companies doing all kinds of creative things these days for their employees. Is there something I can do for certain employees to entice them to stay?”

“I wish there was a bonus I could pay my employees but require them to stay for a certain period of time before they’re fully vested in it.”

RIGHT QUESTIONS TO ASK

“Would you be interested in providing a bonus arrangement to critical employees that provides them a meaningful benefit but restricts their access to it until an agreed-upon timeframe with the company?”

“Would you want to hear about what some other companies are doing to keep their key employees in this crazy job market?”

NON-QUALIFIED DEFERRED COMPENSATION (NQDC)

Retention tool for top talent.

CONCEPT DESCRIPTION

Business owners know that once they've secured top talent, it's important to keep those talented individuals happy to retain their employment. A creative way to show they're appreciated is with a non-qualified deferred compensation plan (NQDC) funded with life insurance.

A NQDC plan allows the employee to save for their retirement by deferring some of their salary. The company can also contribute to the plan, or it can be funded through a combination of both. NQDC plans offer flexibility to meet specific needs. If informally funded with life insurance, the company will receive the death benefit and recover costs of the plan.

The deferred portion of the employee's salary doesn't create a tax deduction for the employer initially, but it does get a tax deduction when the employee receives distributions from the plan. Distributions are taxed as ordinary income to the employee.

CLIENT PROFILE

Employer identifies a key executive or employee at a company and wishes to provide an additional benefit for exceptional service to entice them to stay with their company.

The business may or may not be willing to contribute money to the employee's plan. The employee wishes to defer some of their salary for retirement planning and doesn't wish to pay taxes on that deferred income currently.

Key Selling Points

- Employer can pick and choose who to offer this plan to, and it doesn't impact other qualified plans in place
- Employee provided with a creative way to save additional funds for retirement
- Using life insurance to fund the plan allows the business to be the owner and beneficiary and recoup costs associated with the plan
- Allows the money invested to grow tax-deferred while in the plan
- Straightforward to implement and maintain as it is subject to limited ERISA rules
- Plan can put an employee in a lower tax bracket in the current year by choosing to defer some of their current salary



CASE STUDY

Scott owns an upscale restaurant and worries that his head chef, Josh, will get recruited away.

Josh earns a \$200,000 salary and receives a bonus based on the restaurant's performance.

For the last several years, Josh has averaged an annual bonus of \$200,000. Scott decides a creative retention tool is to offer Josh an additional way to save money for retirement over and above the 401(k) plan the company already offers. Scott offers to match 50% of whatever Josh puts into the NQDC plan that's set up.

Josh elects to defer \$75,000 annually, and the company will contribute an additional \$37,500 annually. The NQDC plan is funded with a life insurance policy on Josh's life. When Josh retires or if he becomes disabled, he can use these additional funds as income in retirement.

Josh is currently in the 35% tax bracket, so some of his income is being taxed at that rate. Josh lowers his overall income tax rate by being able to defer income that would have been taxed at his max 35% rate.

CLIENT COMMENTS TO WATCH FOR

"I'm worried about one of my key employees leaving. That'd be very hard to recover from."

"I hear about companies doing all kinds of creative things these days for their employees. Is there something I can do for certain employees to reward them?"

"I wish there was a bonus I could pay certain employees that was easy to implement."

RIGHT QUESTIONS TO ASK

"Would you be interested in providing a bonus arrangement to employees you can't afford to lose that provides them a meaningful benefit?"

"Would you want to hear about what some other companies are doing to keep their key employees in this crazy job market?"

LOAN REGIME SPLIT-DOLLAR PLANS

Life insurance policy can be collateral for loaning an employee premiums.

CONCEPT DESCRIPTION

An employer can provide an employee with life insurance coverage for their family by lending the premiums to the employee. The employee collaterally assigns the policy to secure the loan but can designate the policy's beneficiary for over and above the outstanding loan amount.

The employee can obtain a significant life insurance policy using the employer's dollars and let it grow tax-deferred over time. The loan to the employer can be paid off in the future using policy cash values or at death by the death benefit proceeds. The employee is taxed each year on the imputed interest income of the loan.

CLIENT PROFILE

Employer identifies a key executive or employee who wishes to obtain life insurance coverage. By offering to loan the employee the premiums and use the policy as collateral, the company still has an asset on the books. A Loan Regime Split-Dollar plan can provide a key employee with a unique benefit that allows them to provide life insurance benefits for their family and potentially build up some excess cash to utilize in retirement.

Key Selling Points

- Employer can pick and choose who to offer this plan to
- Employee is provided a creative way to provide life insurance for their family and save additional funds for retirement
- The employee is taxed on the imputed interest income of the loan
- Employer and employee enter into a written split-dollar agreement, and some annual accounting needs to be administered

CASE STUDY

Brian is an executive at a software company and wants to obtain a large permanent life insurance policy for his family. His financial planner suggested he propose a Loan Regime Split-Dollar plan to his employer as an additional benefit to Brian that allows the company to recoup all the costs of this benefit in the future.

The company agrees to loan Brian \$75,000 annually for 10 years to fund an index universal life policy. Brian assigns the policy to the company as collateral for the outstanding loan balance. Brian gets to designate the beneficiary of the death benefit over and above the loan repayment amount.

Brian also can repay the loan to his employer in the future or at retirement by using the policy's cash value and keep the remaining policy values and death benefit for his family.



CLIENT COMMENTS TO WATCH FOR

“I’m really worried about one of my key employees leaving; it’d be very hard to recover from.”

“I hear about companies doing all kinds of creative things these days for their employees. Is there something I can do for certain employees to reward them?”

“I wish there was a meaningful benefit I could provide certain employees that I could recoup the costs for later.”

“Could I borrow money from someone to fund a life insurance policy? I don’t have the disposable income to fund a life insurance policy properly.”

RIGHT QUESTIONS TO ASK

“Would you be interested in providing a meaningful benefit to employees you can’t afford to lose and that you can recoup the costs for later?”

“Would you want to hear about what some other companies are doing to keep their key employees in this crazy job market?”

“Do you think your employer would be willing to loan you money to fund a life insurance policy if they were assigned that policy as collateral and would eventually get their money back?”

NON-EQUITY ENDORSEMENT SPLIT-DOLLAR PLANS

The company owns the life insurance policy but the employee names the beneficiary.

CONCEPT DESCRIPTION

An employer can provide a way for an employee to obtain life insurance coverage for their family by the employer purchasing a life insurance policy on the employee's life. The employee designates the beneficiary for the death benefit above the employer's contributions or policy cash value, whichever is greater.

The employee can obtain life insurance coverage using the employer's dollars, and the employee is taxed each year on the value of that year's life insurance protection. That amount is determined using the carrier's one-year term rates or the government's Table 2001 rates.

CLIENT PROFILE

Employer identifies a key executive or employee who wishes to obtain life insurance coverage. By obtaining and owning a life insurance policy on the employee and paying the premiums, the company owns and controls the policy but provides a benefit to their employee at a reduced cost.

Key Selling Points

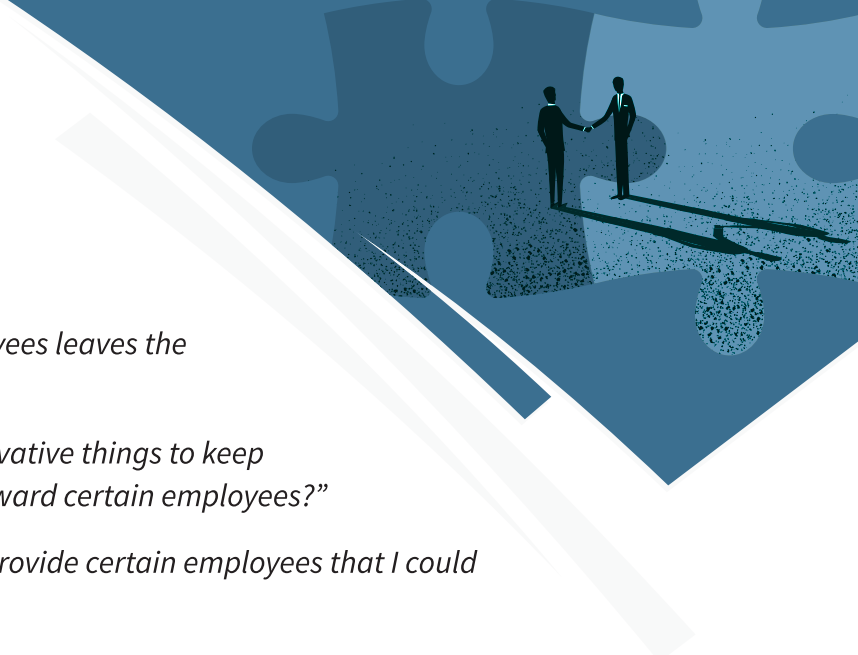
- Employer can pick and choose who to offer this plan to
- Employee gets a creative way to provide life insurance for their family at a much-reduced cost
- The employee is taxed annually on the value of that year's life insurance coverage determined by the carrier's one-year term rates or using Table 2001 rates
- Employer and employee enter into a written split dollar agreement, and there's some annual accounting that needs to be administered
- At employee's death, the death benefit repays the company for its premium payments or the policy's cash value (whichever is greater), and the remaining amount goes to the employee's beneficiary income-tax-free

CASE STUDY

Whitney is a territory manager at a medical device company and is looking to obtain a life insurance policy for her family. Her financial planner suggested she propose an endorsement split dollar plan to her employer. This benefits Whitney and allows the company to recoup all the costs of this benefit in the future.

The company agrees and purchases a \$5,000,000 life insurance policy on Whitney and pays the annual premium. She gets to designate the beneficiary of the death benefit over and above the company's reimbursement amount.

Whitney pays income tax based on the carrier's one-year term rate for the amount of death benefit her beneficiary would have received in that year. Whitney appreciates the affordability of this coverage amount for her family.



CLIENT COMMENTS TO WATCH FOR

“It’d be tough to recover if one of my key employees leaves the company.”

“I hear about companies doing all kinds of innovative things to keep employees. Is there anything that I can do to reward certain employees?”

“I wish there was a meaningful benefit I could provide certain employees that I could recoup the costs for later.”

“Could my employer somehow provide the life insurance coverage my family needs? I don’t have the disposable income to fund a large life insurance policy properly.”

RIGHT QUESTIONS TO ASK

“Would you be interested in providing a meaningful benefit to employees you can’t afford to lose and that you can recoup the costs for later?”

“Would you want to hear about what some other companies are doing to keep their key employees in this crazy job market?”

“Would your employer be willing to fund a life insurance policy if they owned that policy and would eventually get their money back while endorsing over to you the excess death benefit?”

BUY/SELL PROTECTION FOR BUSINESSES

A vital tool for any business.

CONCEPT DESCRIPTION

A buy/sell agreement ensures stability in business transitions and prevents heirs from having to run or sell the business after an owner dies. Typically, a buy/sell agreement states the remaining owner(s) will buy the ownership shares of the deceased or disabled partner.

To fund this purchase obligation, the business owners purchase and own life insurance and a disability policy on the life of each owner. When an owner dies, the death benefit provides the cash to buy the deceased owner's shares from their estate. This protects the deceased's family and other owners from any unintentional business partner.

There are three common types of agreements based on the number of company owners:

1. **Cross-Purchase Agreement:** Each owner buys insurance on every other owner equal to their share of the buyout. Upon death, the death benefit gives the remaining owner(s) the cash to buy out the deceased owner's shares. Since each individual owns their policy, they get a step-up in basis for the acquired shares.
2. **Entity-Purchase Agreement:** The business buys and owns insurance equal to the buyout for each owner's shares. Upon death, the company receives the death benefit and uses it to buy out the shares from the deceased owner's family. The remaining business owners won't receive a step-up in basis for the acquired shares.
3. **One-Way Agreement:** An individual (usually a key employee) has agreed to buy the business from the sole owner. The proposed buyer will purchase insurance on the current owner to fund the purchase if the owner dies before the transition or sell date.

CLIENT PROFILE

Any business owner who needs liquidity to fund an efficient transfer of ownership of their business interests upon their death. Or, any business owner who desires to protect each current owner from unintentional business partners and intends for their family to receive a buyout instead of the burden of running a business should they die before retirement.

Key Selling Points

- Ability to provide the capital needed to buy out a deceased partner's shares without having to pay out of pocket for the shares per the written buy/sell agreement
- A current business valuation and future growth projection are vital to understanding how much life insurance coverage is needed to fund the agreement
- Term insurance is an option to fund the agreement or a cash value policy that's transferrable to the owner should they leave the business
- Heirs who aren't involved in the business get needed cash instead of business shares



CASE STUDY

Bob and Jim started a local sign company that's grown in value to \$5,000,000, and each owns 50% of the business. Bob and Jim created a buy/sell agreement that dictates what'll happen if either becomes deceased or disabled.

Bob buys a life insurance policy on Jim's life for \$2,500,000, and Jim does the same on Bob's life. Both pay the premiums and own the policy individually. If Bob passes away, Jim receives a \$2,500,000 cash death benefit from the insurance carrier, which he uses to buy Bob's shares from his heirs. This means Jim won't have to be business partners with Bob's spouse or kids who aren't involved in the business. Jim also has a cost basis of \$2,500,000 for the shares he purchased from Bob's estate, meaning he owes less tax at the time of the sale of the business.

CLIENT COMMENTS TO WATCH FOR

"I worry what'll happen if my business partner dies."

"We have a buy/sell agreement, but I don't know where I'll get the money to buy my partner out if he passes away."

"I don't want my spouse to have to help run the company if I were to pass away."

"We haven't purchased any life insurance to fund a buy/sell agreement because we don't know how much or what type of life insurance to buy."

RIGHT QUESTIONS TO ASK

"Do you have a buy/sell agreement for your business?"

"Do you have the capital to buy out your partner if they pass away, or would you be interested in shifting some of that risk away?"

"Do you have a current business valuation to ensure your family gets the full amount if you die before you retire?"

"Would you like a specialist to review your current buy/sell agreement to ensure you and your partners are properly protected and it's up to date?"



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