CIA | CONSOLIDATED INSURANCE AGENCIES

Death and Disability insurance

The death or serious disablement of an owner through illness or injury can put tremendous strain on a business and create financial problems amongst others.

For example, if a business owner dies, in the absence of any specific arrangement their interest in the business is likely to be distributed in accordance with their Will (for example to their surviving spouse).

As the new part-owner of the business, their spouse would then be entitled to the same Management and Financial rights as the deceased owner, but how would the remaining owner (s) feel about admitting a new owner to the business?

How can death or disability impact a business with multiple owners?

The death or serious disablement of an owner, through illness or injury, can put tremendous strain on a business and create financial problems, amongst others. For example, if a business owner dies, in the absence of any specific arrangement, their interest in the business is likely to be distributed in accordance with their Will (for example to their surviving spouse).

As the new part-owner of the business, their spouse would then be entitles to the same management and financial rights as the deceased owner. But how would the remaining owner(s) feel about admitting a new owner into the business? Would the new owner have the necessary skills or experience to assist in running the business? Would the new owner even want to be involved, or would they prefer to receive fair value consideration of their shareholding?

Potential problems can also occur if an owner becomes disabled and is unable to work in the business. In this scenario, the remaining owner(s) will need to do all the work but the disabled owner will still receive their share of the profits – an outcome that could put the business under pressure and test the relationship between the various owners.

To protect the business and ensure an orderly transfer of ownership, a Buy Sell agreement should be considered

What is a Buy Sell agreement?

A Buy Sell agreement is a legal contract between business owners made up of two components. The first component outlines what will happen to each owner's interest in the business if certain trigger events occur (death, permanent disability or critical illness). While this is usually done by entering into a transfer agreement, it can also be addressed in a partnership or shareholders agreement.

Secondly, the owners need to put in place a funding agreement which outlines how the money will be raised to finance the ownership transfer, including any associated tax bills.

There are a number of ways a Buy Sell agreement can be funded. For example, the remaining business owner(s) may be able to buy-out the departing owner's interest using their own capital or borrowed money. However, these options are not always available as many financial institutions may be reluctant to lend money to a business that just lost the services of a key person.

To ensure the capital is available in the event of death or disability, an insurance policy is usually considered the most cost-effective and efficient funding solution.

What are the benefits of a Buy Sell agreement

A Buy Sell agreement can provide a number of key benefits. These include:

- Stabilising the business and helping it to continue as a viable operation
- Enabling the remaining owner(s) to acquire the departing owner's interest in the business
- Reducing the risk of ownership disputes, and
- Ensuring the departing owner or their estate dependants receive adequate financial compensation for the disposal of their interest in the business.

Case Study

Michael and Bill each owned 50% of the shares in a successful engineering business which is valued at $4 million ($2 million each.) when Bill died suddenly.

Before his death, Bill had decided to distribute the shares to his wife Lynn, via his Will. However, Lynn doesn't have the skills or inclination to help run the business. Michael doesn't have the sufficient funds to buy out Lynn. Even if Michael was able to borrow the funds from the bank, the annual interest cost alone would equate to $120,000 ($2 million at 6%pm interest rate).

A better approach would have been to execute a Buy Sell agreement, funded by insurance. By using this strategy, Lynn would receive the insurance proceeds in exchange for handing over her interest in the business to Michael. As a result, Lynn would be fully compensated and Michael would take ownership of 100% of the business and receive 100% of the profits. The cost of a $2 million Life TPD policy for a 45 old male non-smoker would be approximately $4,000 per year.

How Steadfast Life can help to protect your business:

Although there is a perception that buy/sell agreements are complicated, they can be executed quite simply by seeking specialist advice.

Steadfast Life will undertake the detailed analysis required to tailor specific protection packages to meet the individual needs of your business. We will work with you to identify key ownership considerations and through research will ensure policies are structured in a comprehensive and cost efficient manner.

Consolidated Insurance Agencies have partnered with Steadfast Life, a specialist Life Insurance adviser firm, to provide Life Insurance solutions to our clients.

To protect the business and ensure an orderly transfer of ownership. A 'Buy Sell' agreement should be considered.

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"CIA provide the highest level of service and professional standards whilst ensuring essential insurance protection for each and every one of our customers."

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