

Protecting the future of your business

A business insurance guide for the small business owner



Policies issued by:

American General Life Insurance Company

**The United States Life Insurance Company
in the City of New York**

Your business is a source of income for you and your family, as well as for your employees. It takes sound business practices to maximize the income of your business while managing the risks that could jeopardize its future.

Protecting the future of your business requires a team of professionals working together to achieve your goals. This team includes:

Team Captain – You set forth the objectives that every member of the team strives to achieve.

Attorney – He or she is uniquely qualified to provide legal counsel and to draft certain documents necessary to implement many of your business plans.

Accountant – He or she assists in the preparation of tax returns and other financial transactions. The services of an accountant are also instrumental in business valuation.

Insurance Professional – The insurance professional is often the catalyst that brings the team together. He or she can provide access to the insurance products that can fund your business continuation and estate plans, as well as retirement and employee benefits.

This guide will provide you with general information on some common business insurance concepts. This information is general in nature and is not intended to be legal or tax advice. American General Life Companies, its subsidiaries, its affiliates, its employees, its representatives and its agents do not provide tax or legal advice. Please consult your legal, financial, and/or tax advisor(s) with regard to your specific factual situation.

Business Continuation

The death, disability or retirement of a key employee or business owner can cause economic uncertainty and jeopardize a profitable continuation of the business. Following is a summary of common planning techniques that can help protect the future of a business.

Key Employee Life Insurance – Protects against the financial loss that might occur at the untimely death of an individual whose expertise is vital to the success of the business. When properly



structured, the death benefits from key employee life insurance may be received 100 percent income-tax free by the employer.¹ There are several methods of determining how much insurance is needed. A common rule of thumb used by some financial professionals is an amount equal to five times the key employee's salary. A number of businesses carry term life insurance on their key employees. Other firms carry permanent life insurance because the cash values of permanent life insurance are business assets and can be used for various business purposes including retirement income.

Buy-Sell Agreement – Provides for the orderly continuation of a business at the death, disability or retirement of a business owner. It assures that the family of a business owner will receive the full value of his or her share of the business. A Buy-Sell Agreement establishes the price of the business, commits a buyer (usually a partner, shareholder, or the business itself) to the purchase and provides for funding the purchase. Life and disability insurance provide a cost-effective way to fund the plan. Depending on several factors, the agreement can be structured as an entity purchase or a cross-purchase plan. Your attorney can help you decide which is best for your business.

Internal Revenue Code Section 303 Stock Redemption – Provides for the partial redemption of stock to pay estate settlement costs and helps to assure the continuation of a family-owned business. Life insurance may provide cost-effective funding. Please consult your legal/tax advisor to determine if your business is eligible for this type of arrangement and if it is appropriate for your situation.

¹ For employer-owned life insurance policies issued after August 17, 2006, IRC Code Section 101(j) requires that certain notice and consent requirements be met if death benefits are to be received income-tax free. Consult with your tax advisor for more details.

Retirement and Benefit Plans

Providing retirement and other employee benefit plans for you and your employees is important to the future of your business and requires sound risk management. Following is a summary of some of the most popular types of benefit plans.

Group Insurance – Health and life insurance benefits can be provided for the employees of your business under a group insurance plan. Other types of insurance, such as dental and disability, can also be provided under a group plan. The premiums paid by an employer for group insurance may be tax deductible by the employer.

Retirement Plan – A tax-qualified pension or profit-sharing plan can help provide retirement income for you and your employees, as well as help reduce current income taxes. However, the cost of administering these plans may often outweigh the tax benefits for some small businesses. Possible alternatives to traditional retirement plans are a Simplified Employee Pension or a Savings Incentive Match Plan for Employees (SIMPLE) plan. These types of retirement plans have lower administrative costs, but still provide significant tax benefits.

Executive Bonus Section 162 Arrangement – An employer-paid bonus is used to purchase additional life insurance for a key employee or business owner. The employee owns the policy and names the beneficiary, and can use the cash value to supplement retirement income. The bonus is taxable income to the employee and may be tax deductible to the business, subject to certain conditions.

Split-Dollar Insurance – The business and a key employee or business owner share the cost and benefits of a life insurance policy on the life of the employee, and, the employee or business owner may incur only a modest cost or premium share as part of the Arrangement. Split-Dollar may be a useful technique to provide cash for income replacement, or to help pay estate taxes for a larger estate.

The value of your business is probably a major part of your estate.



Consult with your insurance representative for more details. Split-Dollar Insurance Arrangements can be structured in several ways depending on the needs and objectives of the business and the key employee. IRS regulations have impacted the way a key employee is taxed on a Split-Dollar Arrangement, so you should consult with your tax advisor.

Deferred Compensation – A nonqualified arrangement provides retirement income to supplement a pension or other qualified retirement plan. Key employee life insurance is often used to informally fund the plan and provide cash to recover the employer's cost. Benefits are taxable to the employee and tax deductible to the business when paid. Internal Revenue Code Section 409A, Nonqualified Deferred Compensation Plans, may impact the arrangements. Please consult your tax/legal advisor with any questions.

Salary Allotment Arrangements – These arrangements allow employees to purchase personal life insurance on a voluntary basis and pay premiums through payroll deduction. Since premiums are paid with employee dollars, there is no direct cost to the business.

Estate Planning

The value of your business is probably a major part of your estate. Estate taxes and other costs may significantly reduce the amount of the estate that you are able to pass on to your heirs when you die. Following are some commonly used estate planning concepts that many business owners consider. Each of these options should only be undertaken with the advice of a competent tax advisor and/or attorney.

Wills – A will is the starting point for every estate plan. It determines, in writing, to whom and in what manner your property will be distributed when you die. State law determines how your estate is handled if you do not have a will.

Estate Equalization – It may be your desire to pass your business to children who are active in the business. If you have other children who are not interested in taking a part in the business, you may ask the question: “How do I provide an inheritance for them that is fair?” If this issue is not resolved prior to your death, it may result in the forced sale of your business or the imposition of a burdensome debt merely to satisfy distributions to your children not active in the business. Life insurance may serve as a valuable tool to help solve this problem. Non-active children are named as beneficiaries of life insurance in an amount which each child would have received had your estate been evenly divided. The child active in the business would typically receive the entire business interest. The result is a distribution plan which considers the needs of both active children – the continuation of the business – and non-active children – cash inheritance.

Charitable Gifts – By giving money or property to a charity, you may reduce the amount of your estate that will be subject to estate settlement costs. Charitable gifts may also be income tax deductible.

Marital Deduction – In some instances, an individual can transfer an unlimited amount of wealth to his or her spouse during lifetime or at death without incurring gift or estate taxes. However, this only defers the payment of estate taxes until the surviving spouse dies.

Estate Exemption/Gift Exemption² – The estate exemption amount was \$3.5 million in 2009, is unlimited in 2010 and returns to \$1 million in 2011. An estate valued at less than the exemption amount will have no federal estate taxes due. Since the end of 2004, the exemption amount for estate and gift taxes differ and is no longer unified. Gift exemption amount remains at \$1 million.

Internal Revenue Code Section 6166³ – The estates of some business owners may elect to pay estate taxes in installments. For an estate to be eligible for this option, at least 35 percent of the estate must consist of ownership in a business. The estate is charged interest.

² There is currently uncertainty with regard to legislation pertaining to the estate tax. Please consult your tax advisor with any questions.

³ American General Life Companies’ insurers, their affiliates, employees, representatives and agents, do not provide legal or tax advice. Please consult your legal, financial, and/or tax advisor(s) with regard to your specific factual situation.



Life Insurance – Insurance can provide funds to pay any remaining estate costs after the marital deduction and unified credit have been used. Typically, the total premiums paid for the insurance are usually significantly less than the amount of insurance death benefit provided (known as the “discounted dollars” concept).

Having adequate life insurance can help prevent a forced sale of a business or other assets to pay estate settlement costs. Also, properly arranged life insurance may be income tax- and estate tax-free and is received by beneficiaries exactly when it is needed.

Trust Arrangements – Probate fees and estate taxes can be reduced or eliminated by transferring property to a properly established trust. This typically means giving up control of the property. This may or may not be acceptable to you. Also, life insurance owned by a trust can provide funds to pay estate settlement costs.

Summary

A successful business does not happen by accident. In addition to hard work, it takes sound risk management. Taking steps to protect the future of your business includes:

- Removing or reducing uncertainty
- Providing financial security
- Protecting and preserving your assets

Many of the concepts discussed in this booklet can be funded by insurance products available through the insurers of American General Life Companies. Working with your insurance professional, you can determine the right type of policy and the appropriate amount of insurance for your specific situation.

This guide is a general summary of business insurance concepts and is not intended to provide tax or legal advice. Consult tax and legal professionals concerning your specific situation.

This guide is a general summary of estate and business planning and is not intended to provide specific tax or legal advice. Individuals should consult their tax and legal advisors concerning their specific situations. American General Life Companies' insurers, employees, agents and representatives do not provide tax or legal advice.

American General Life Companies

Policies issued by:

American General Life Insurance Company

2727-A Allen Parkway, Houston, Texas 77019

The United States Life Insurance Company in the City of New York

70 Pine Street, New York, New York 10270

The underwriting risks, financial and contractual obligations and support functions associated with the products issued by American General Life Insurance Company (American General Life) or The United States Life Insurance Company in the City of New York (United States Life) are the issuing insurer's responsibility. United States Life is authorized to conduct insurance business in New York. Policies and riders not available in all states.

American General Life Companies, www.americangeneral.com, is the marketing name for the insurance companies and affiliates comprising the domestic life operations of American International Group, Inc., including American General Life and United States Life.

© 2010. All rights reserved.

AGLC100938 REV0210