Retirement & Estate Planning

in the Business Planning Market

Retirement & Estate Planning For Business Owners

Business owners have many of the same individual planning needs as their non-business owner counterparts. While the importance of saving for retirement and creating an estate plan is not lost on business owners, they are often so busy running the day to day operations of the business that these important planning needs get put on the back burner. As the advisor, you can help remove the obstacles preventing a business owner from moving forward with important personal planning by:

- IDENTIFYING POTENTIAL PITFALLS from lack of planning;
- PROVIDING OPTIONS to consider;
- OUTLINING NEXT STEPS to take to accomplish goals or address pitfalls;
- PROJECTING RETIREMENT INCOME and/or exposure to estate taxes; and
- DISCUSSING IMPORTANT TAX IMPLICATIONS to their overall plan.

Retirement Planning

Will the owner have enough in retirement?

As of 2017, roughly half of today's households will not have enough retirement income to maintain their pre-retirement standard of living.[1] The statistics regarding Americans preparedness for retirement can be unnerving, especially when it comes to small business owners. A study released by the Small Business Administration in 2010 indicates that retirement account ownership, contribution, and participation rates for small business owners are low — only 18% participate in a 401(k)/Thrift plan, less than 2% own a Keogh plan, and only about 36% own an IRA (and of those individuals, only 33% actually contributed to the IRA). Moreover, self-employed individuals are less likely to hold a retirement account as compared to those who are wage-and-salary workers.

Even business owners who are utilizing more traditional retirement vehicles may be concerned about retirement planning, particularly with regard to contribution limits and access to plans, which prevent higher-income business owners from putting aside enough money for retirement that will allow them to maintain their pre-retirement standard of living.

Although there are numerous reasons why business owners may not be contributing to traditional retirement savings accounts, three of the most often-cited reasons are:

- They are **not going to retire** from their business
- They are going to **sell the business** and use the proceeds for retirement needs
- **Barriers to entry and exit** from traditional retirement savings plans

NOT GOING TO RETIRE

Even though a business owner may not envision a retirement where they are not part of the business, it is important to explore the various scenarios. What if they have a change of heart and no longer want to work? What if they experience an illness or life event that prevents them from working?

SELLING THE BUSINESS

Relying on a sale of the business for retirement income can have significant risks, including:

- The value of the business at retirement can be hard to predict, especially since the owner will no longer be involved
- It might be difficult to find a buyer at the appropriate time. Retirement income can be reduced if the owner gets sick or injured prior to selling the business
- The decision to sell the business may be changed if family members are actively involved in the business

SKEPTICAL OF TRADITIONAL PLANS

For many business owners, contributing to a traditional retirement plan is not ideal because they may be restricted from accessing the money contributed without being penalized. Additionally, concerns with regards to administration of a plan (and the costs associated with them), contribution limits, and having to offer plans to other full time employees prevent many owners from pursuing traditional retirement accounts.

Once you have a clear picture of what the business owner would like his or her retirement to look like, including an approximate age of when he/she would like to be financially independent/retired and the progress he/she has made towards accomplishing these goals, consider using the **John Hancock Retirement Needs Calculator**. This compares current assets earmarked for retirement against stated future income goals and calculates any potential shortfall between the two.

How can life insurance help when it comes to retirement planning?

Cash value life insurance can help business owners by providing a tax-advantaged source of supplemental retirement income on top of death benefit protection. Consider the following benefits of using life insurance as a part of an overall retirement strategy:

Tax Advantages	Life insurance can provide a tax-free death benefit and tax-deferred cash value growth. For business owners who are constantly thinking about taxes, life insurance can provide discretionary non-reportable tax-free income because distributions from policy cash value can be accessed tax-free via loans and withdrawals.
Creditor Protection	Depending on state law, life insurance may provide creditor protection of both the accumulated cash value and death proceeds.
Flexibility	Unlike a 401(k) plan, IRA or other retirement accounts, a life insurance policy does not have contribution limits, can be accessed prior to 59½ without penalty, and does not have required minimum distributions. Additionally, a properly structured policy can have flexibility traditionally not available with other plans allowing the business owner to put more money in the policy in some years and skip premiums in others.
Long-Term Care	A life insurance policy with a long-term care rider can protect the business owner by providing tax-free acceleration of death benefit if the owner has a qualified long-term care event.

For business owners, a permanent life insurance policy can provide long term flexibility to help them become financially independent and ready for their retirement years.

Clients may be skeptical about using life insurance as a supplemental retirement vehicle as compared to using more traditional investment options. Consider using the IRR reports available with a policy illustration and/or an *"Invest in Your Life"* presentation (available in JH Illustrator and JH Solutions) to demonstrate the competitiveness of using life insurance as part of a well-diversified retirement strategy.

Estate Planning

Clients engage in estate planning to properly execute their wishes and distribute their accumulated wealth. With business owners, there is an additional layer of complexity given that the business may make up a large portion of the estate. Estate Planning encompasses succession and buy sell planning, but it is much more than that, it is managing the business as an asset in their personal estate.

Estate planning includes making sure that wills, trusts, power of attorney, and health care proxies are in place, but it also encompasses making sure your client's legacy continues and that their family is provided for.

Planning Opportunities

Life insurance to pay estate taxes

The federal estate tax exemption has been increased to over $10 million ($20 million[2] for married individuals), indexed for inflation, but in 2026 this amount is scheduled to revert to $5M, indexed for inflation. High-net-worth business owners must consider the potential impact of federal estate taxes and may need to find liquidity to pay for the estate tax, which is generally due 9 months after death. Without proper planning to address these liquidity needs, the estate of a business owner may need to sell business assets in a short period of time, creating an unfavorable fire sale of the business the owner worked so hard to create and make profitable.

Life insurance has been used by many business owners as a means to cover the estate taxes due and provides liquidity for the client's estate right when it is needed most. In order to keep the death benefit proceeds outside of the business owner's taxable estate, life insurance will typically be owned in an Irrevocable Life Insurance Trust (ILIT).

In addition, many business owners who qualify can also look into a 6166 election, which allows for the estate tax to be paid and stretched over a period of time (generally 15 years, and generally at favorable interest rates). A 6166 election combined with life insurance owned in an ILIT is a powerful strategy that helps prevent a fire sale of a business and with cash flow — although ultimately liquidity may still be a problem. See our *BYA: Section 6166 — Deferring Estate Taxes* or call Advanced Markets for more information.

State Estate Taxes

Even if your affluent business owner client is not subject to federal estate tax, do not overlook state estate tax. While this tax is lower than the federal one, it is still one that can require liquidity and can potentially affect those who are worth less than $20M. Since state estate tax law is specific to the state, use our Know the Law tool to find out what the state exemption is in your client's state.

Estate equalization

Does your client want his/her business to be transferred to children or other close family members? Do the children get along? Is one child more invested in the business than the others? Does the owner want all the children to get equal shares of the business? What does the business owner think is fair? Has the client made plans to take care of and/or protect a surviving spouse who may not be involved in the business?

Passing on a family business to the next generation can present administrative and practical challenges, especially when some heirs are more active in running the business than others. It is not uncommon for conflicts to occur between heirs who are active in the business and those who are not over salaries, dividends, asset purchases, etc. On the other hand, leaving a business entirely to certain heirs and excluding others is almost sure to create inequality and conflict unless the estate has sufficient liquidity to balance inheritances. In circumstances like those, liquidating the asset and distributing the proceeds can seem like the only option if good relations are to be maintained.

Estate equalization is a planning approach that attempts to distribute a client's estate so that all children get an equal or fair share, according to the client's wishes. Liquidity in the estate may be imperative in order to accomplish this equalization especially when a large portion of the estate is made up of business interests. Because a life insurance death benefit offers a pool of liquidity at exactly the time liquidity is needed, it can facilitate estate planning goals, helping to give each heir the inheritance the business owner would want them to receive.

Use our Estate Tax Calculator to estimate estate taxes and help uncover how much life insurance your client will need.

Key Questions TO ASK

Here are some key questions that you can use to initiate a conversation with the business owner regarding his or her retirement and estate planning goals, strategies and shortfalls:

What does your retirement look like?

This is a great way to start a conversation about retirement without putting the business owner on the defensive about whether or not he or she has done enough to meet specific retirement goals.

Have you thought about when you would like to retire?

The owner may have a specific age in mind or may refer to a specific event that may precipitate their retirement (e.g., after children are all out of college, when a successor owner is ready to take over, etc.).

If, the owner says that he or she is never going to retire, consider following-up with:

I understand you love your business and you do not envision ever retiring, but what if you could not work due to an illness or you simply did not want to work any longer — what is plan B?

A discussion with the owner about having to work versus not wanting to/not being able to work should be explored. Often times when speaking to a client who wants to continue to be engaged in their business indefinitely, the focus should shift towards financial independence versus retirement.

If they say they are going to sell the business to retire, follow-up with:

- Who will buy the business? Do they want to transfer the business to family? Key employee? What is the business worth? Does the business fluctuate in value?
- Have you taken any steps to save for retirement outside of your business? If so, what have you done?
- How much are they saving into retirement?
- What is the growth rate of their retirement assets?
- Are they contributing to social security and do they want to factor in social security into their retirement picture?

Do you have a will or trust in place?

- **If yes ...** When it was last updated? Have there been any changes since it was last updated (marriage, divorce, children, grandchildren)?
- **If no ...** Tell me about the legacy you want to leave. Have you decided how you would like to distribute assets to your spouse, children, and grandchildren?

Do you own life insurance? If yes, how much and how did you determine the amount that you need? Who are the beneficiaries of your life insurance? Who owns the life insurance?

Sometimes a business owner will have life insurance for buy sell coverage, and while this is part of the equation, it probably doesn't help with other personal needs such as covering mortgages, and other goals.

What is your total net worth?

This question is meant to determine if your client may be subject to Federal Estate Taxes or state estate taxes. If your client's estate or joint estate with his or her spouse is large enough to be subjected to either federal or state estate taxes, consider asking the client if he or she is concerned about the estate's ability to pay estate taxes. See the following pages for more information on federal and state estate taxes.

Who is going to take over your business? Tell me more about that transition; are you transferring the business to children or other family members?

Succession planning is about transferring the business and allowing the business to continue and grow as part of a legacy. If transferring the business to family, one should consider how the business will be divided among the family members and/or consider how to make things fair and equitable to those family members who may not be involved in the business after its transition. If transferring the business to a non-related party, how will that buy-out occur? These are important factors that every small business owner should consider as part of their overall estate plan. To learn more about succession planning, please see our "Business Succession Planning" stand-alone guide.

For more information please call the Advanced Markets Group at 888-266-7498 option 3

1. National retirement risk index shows modest improvement in 2016. crr.bc.edu/wp-content/uploads/2017/12/IB_18-1.pdf January 2018.
2. Increased gift, estate and GST tax exemptions are scheduled to sunset back to $5M (indexed for inflation) after 12/31/2025.

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