

Business Succession Planning

Protecting the family legacy using life insurance

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0260965-00005-00 Ed. 07/2017

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Prudential
Bring Your Challenges®

Funding Buy Sell Plans for Small Business Owner



The
Opportunity

The Market

Planning
Options

Transfer Options

Getting
Started

Reaching out to
Business Owners

The Opportunity : Stats on Size of Market

78%

family owned
small
businesses ¹

40%

Fortune 500
businesses
family owned,
controlled
or influenced ²

36%

small
businesses
with a plan ³

39%

small businesses
with a Plan
that includes
life insurance ⁴

Opportunity

¹ Source: *Small World Trends in the U.S. Small Business Market*, LIMRA 2012

² Source: *Newsweek*, December 29th, 2010

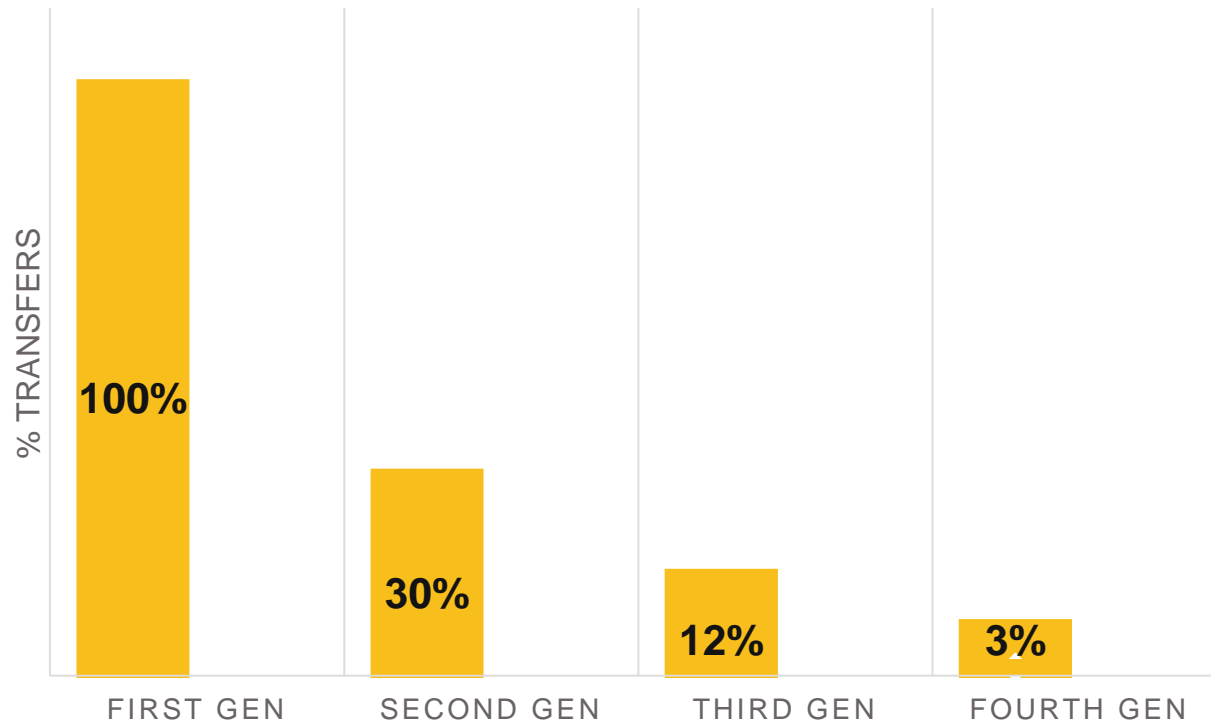
³ *Small World Trends in the U.S. Small Business Market*, LIMRA 2012

⁴ *Small Businesses Owners 2009 Report*, LIMRA International

Statistics referenced on this slide are believed to be the most up to date available as of January 2016

The Opportunity : Stats on Generational Business Transfers

GENERATIONAL TRANSFERS



*Source: Joseph Astrachan, Ph.D., editor, Family Business Review, "Facts and Perspectives on Family Business Around the World" (United States data), January 2005.

Statistics referenced on this slide are believed to be the most up to date available as of January 2016

Why Have Small Business Owners Not Planned?



Lack
of
Viability

Lack
of
Desire

Lack
of
Confidence

Lack
of
Planning

Why Have A Plan?



Creates
Market

Minimize
Disputes

Dictates
Transfer

Fixes
Value

Provides
Liquidity

Plans for
Retirement

Triggering Events



Death

Disability

Retirement

Divorce

Bankruptcy/
Insolvency

Employment
Termination

Planning Options For Transferring the Family Business

Sale

- Buy Sell
- Lifetime Transfers

Gift

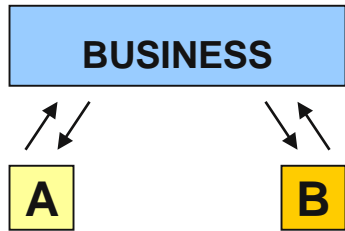
- Lifetime Transfers

Bequest

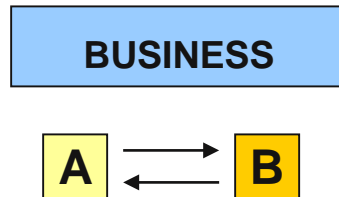
- Estate Transfers

Transfer Through A Buy Sell Plan

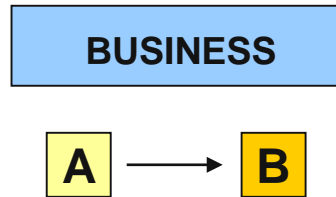
Stock
Redemption



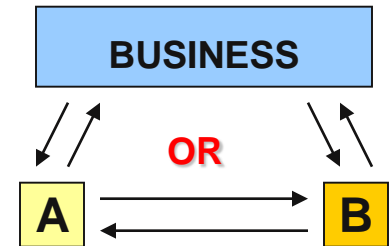
Cross
Purchase



One
Way



Wait &
See



Two Important Rules To Remember



Notice & Consent Rules 101(j)

|

IRC 101(j) Death Benefits from employer-owned life insurance contracts are subject to income taxes-- in excess of premiums and other amounts paid-- UNLESS the notice & consent requirements are satisfied by the employer

Transfer for Value

|

General Rule: Life Insurance proceeds are tax free UNLESS the policy has been transferred for a valuable consideration.

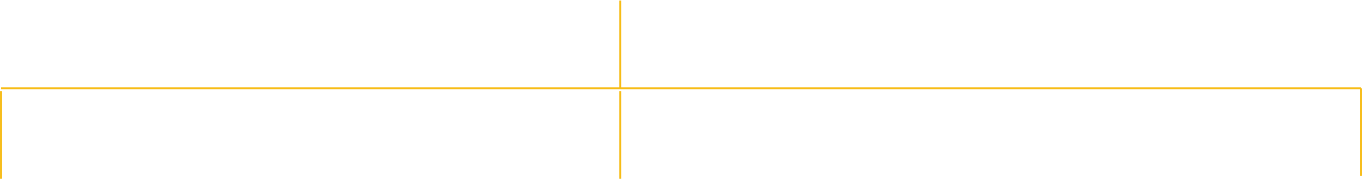
Notice & Consent



Notice & Consent

Rules 101(j)

Notice and consent is generally satisfied if, before the contract is issued, the employee:



1. is notified in writing that the policyholder intends to insure the employee's life and the maximum face amount for which the employee could be insured at the time the contract was issued,

2. provides written consent to being insured under the contract and that such coverage may continue after the insured terminates employment, and

3. is informed in writing that the policyholder (or a related party) will be a beneficiary of any proceeds payable upon the death of the employee.

Transfer For Value

Transfer for Value (TFV)

1. Switch from Cross Purchase to Stock Redemption- **no transfer for value issues**

2. Switch from Stock Redemption to Cross Purchase- **transfer for value issues**

3. Exceptions to TFV:

- Transfers **to Insured**
- Transfers **to Partner/ Partnership** of insured
- **Transfer to Corp.** of which the insured is an officer or shareholder

4. Transfer from co-shareholder to insured in **NOT an exception**

Hypothetical Case



The
Cruz Family

Priorities/
Goals

Strategies/
Options

There are complex legal and tax implications associated with the various strategies illustrated, and your client must consult their own tax and/or legal advisors to determine whether or not any plan or strategy illustrated is appropriate. Insurance representatives are not authorized to practice law or to provide legal or tax advice. The material contained in any illustration is not a substitute for consultation with a competent legal advisor and should only be relied upon in conjunction with his or her advice.

Life insurance policies contain fees and expenses, including cost of insurance, administrative fees, premium loads, surrender charges and other charges or fees that will impact policy values.

All guarantees within the policy are based on the claims-paying ability of the issuing company.

Hypothetical Case: Cruz Family

Chic Leather, Inc	Maker of Leather Boots	Operating Since 1972	\$700,000 Average Net Earnings
Sole Owner Carl, Age 58	Married to Susan, Age 57	Active Child, Maria, Age 33	Inactive Child, Carlson, Age 31

This is a hypothetical example used for illustrative purposes only to describe how the strategies may work. Which strategy works best for clients will depend on their individual facts and circumstances. Actual results will vary. Any representation of life insurance premium or death benefit is purely hypothetical in amount and is not a guarantee of cost or death benefit now or in the future from a specific life insurance policy.

Meet the Cruz Family



Carl

Started business from scratch
Very proud of his success
Loves “smell of leather”
No desire to fully retire soon
Still drives a 2005 Acura

Maria

University of Colorado graduate
Engaged to be married
In the business since college
Responsible for hand bag line
Wants to take over business

Susan

Was stay-at-home mom
Manages office part-time
Loves to travel & spend time w/ Kids/GC
No desire to run business

Carson

Stanford Law School graduate
Married with two young children
Now is a successful lawyer
No desire to work in the business
Not “eye to eye” with Maria

The Cruz Family

Carl and Susan's Personal Financial Statement

ASSETS		LIABILITIES	
Home	\$500,000	Mortgage	\$115,000
Vacation Home	\$275,000	2 nd Mortgage	\$85,000
Cash	\$300,000		
Investments	\$700,000		
Qualified Plan	\$550,000		
Business	\$5,000,000		
Total	\$7,325,000	Total	\$200,000

Priorities & Goals

Have you ever had a professional valuation of the business by an outside resource?

Yes

No

What do you want to see happen with the business upon the following events?

Event	Keep in Family	Sell to a Partner or Employee	Liquidate
Death	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Disability	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Retirement	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

What steps have you taken to ensure an orderly transition of the business to the next generation if you were unable or unwilling to continue running it?

Nothing formal

Transfer by...



Sale

Gift

Bequest

Transfer By Sale

Note / Loan Interest Rate	Note / Loan Duration	Annual Payment	Percentage of Earnings
5%	10	\$647,523	92.5%
5%	15	\$481,711	68.8%
5%	20	\$401,213	57.3%

- Can Maria and/or the business afford the payments?
- How will Carl's death impact the business' credit?

Transfer By Gift

		Percentage of Business Value
Combined Annual Gift Tax Exclusion (split gift) 2016	\$28,000	0.56%
Individual Lifetime Gift Tax Exemption for 2016 <i>*Indexed for inflation</i>	\$5,490,000*	100%
Gift tax due on lifetime transfer in 2016	\$0	0%

- Are they willing to transfer 100% of the business?
- Are there sufficient retirement assets outside the business?

Transfer By Bequest

		Percentage of Business Value
Combined Annual Gift Tax Exclusion (split gift) 2016	\$28,000	0.56%
Individual Lifetime Gift Tax Exemption for 2016	\$5,490,000*	100%
<i>*Indexed for inflation.</i>		
Gift tax due on lifetime transfer in 2016	\$0	0%

- Will there be estate taxes and enough liquidity to pay them?
- How will Susan's financial needs be fulfilled?
- What about the inheritance for Carson?

Priorities and Goals

Follow-up questions:

- For who is the business to be retained? Maria
- How will the business be transferred? Sale or bequest
- Will Carl & Susan rely on the business for lifestyle and retirement needs? Yes, directly or by sale
- Is Susan comfortable being dependent on the business following Carl's death? No, would rather sell
- Where would the funds come from to finance a buyout? Business' earnings?
- How would the business' cash flow be impacted now if used to fund a buyout? Could be burdensome
- Will there be sufficient liquidity to pay estate taxes? Not sure, probably not
- How is Carson's inheritance to be treated? Fairly - other assets

Assess Priorities & Goals

Next Generation Concerns

- Cash flow needs of spouse
- Credit after owner's death
- Goodwill after owner's death
- Liquidity for estate taxes
- Forced sale or liquidation
- Inheritance disputes

Carl & Susan's Priorities

- Financial independence
- Funding to help Maria purchase the business
- Estate tax liquidity
- Fair inheritance for Carson

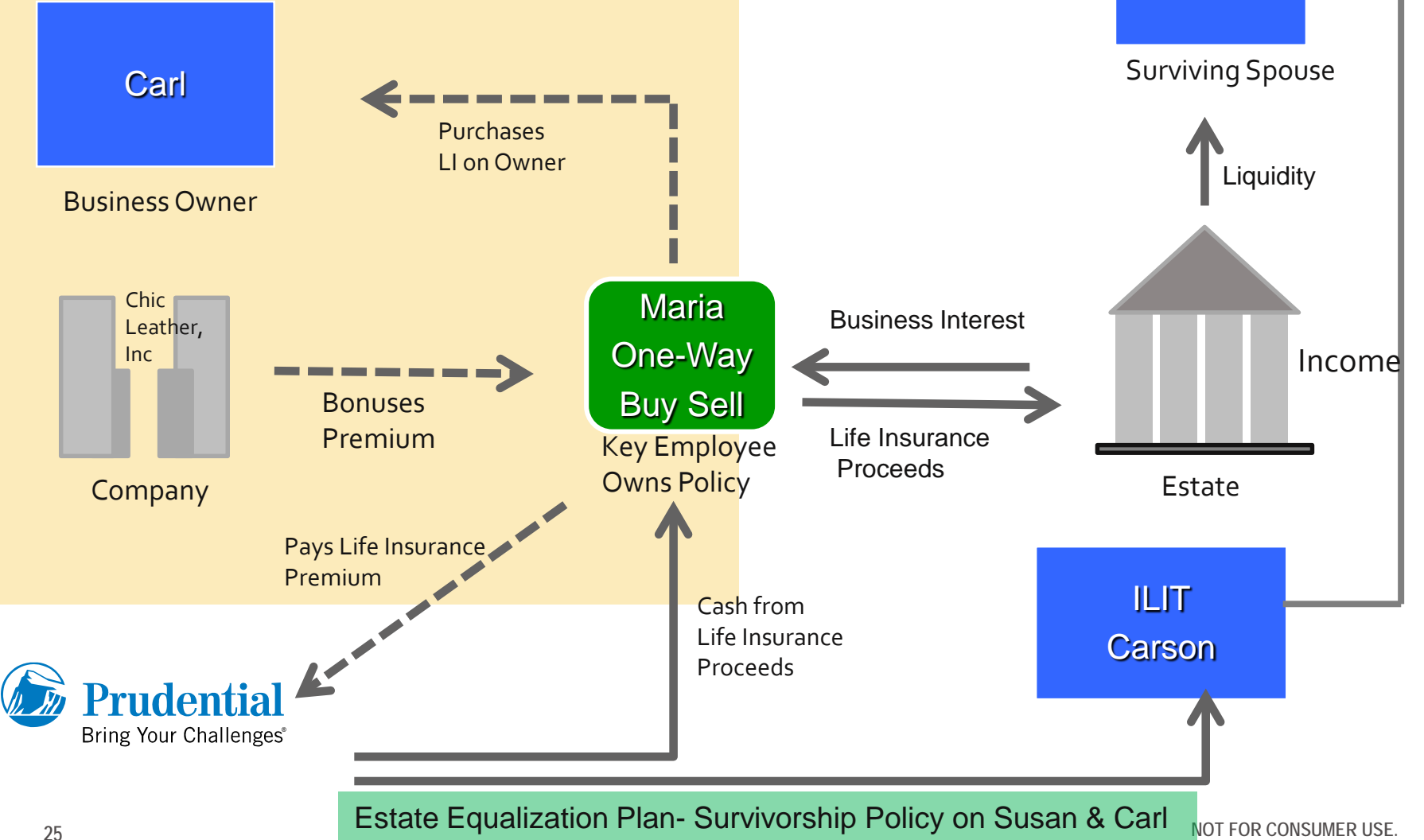
Any life insurance policy values illustrated on subsequent slides are based on the following assumptions. For the single life policy on Carl: Male, age 58, preferred non-nicotine, PruLife Founders Plus, \$5 million level death benefit, level annual premium, solve to endow at age 120, non-guaranteed policy charges and credited interest rate. For the joint life policy on Carl and Susan: Male age 58 and female age 57, both preferred non-nicotine, PruLife SUL Protector UL, \$5 million death benefit, level annual premium, guaranteed to age 105.

Options

FUNDING METHODS	CONSIDERATIONS
Cash	<ul style="list-style-type: none"> • Liquidity
Loan	<ul style="list-style-type: none"> • Credit after death • Interest expense • Cash flow
Installment Sale	<ul style="list-style-type: none"> • Default risk • Cash flow
Sinking Fund	<ul style="list-style-type: none"> • Mortality risk • Performance risk
Life Insurance	<ul style="list-style-type: none"> • Premium affordability • Section 162 Bonus?

Sale: Buy Sell With Estate Equalization

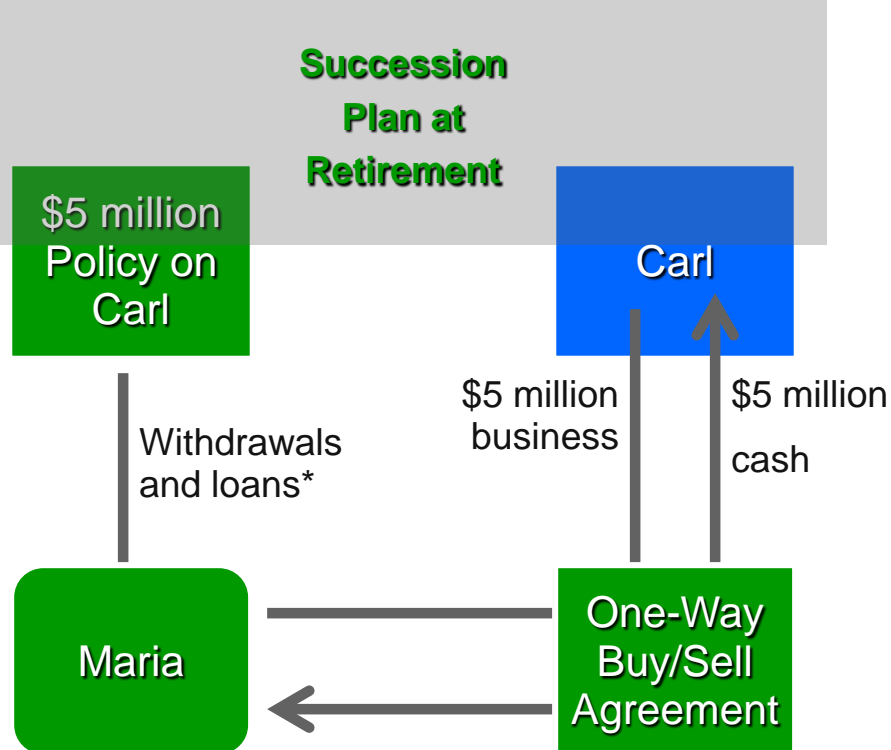
Succession Plan at Death



Estate Equalization Plan- Survivorship Policy on Susan & Carl

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Sale or Gift: Lifetime Transfer



Lifetime transfers:

- Annual or lifetime gifts
 - Installment note sale
 - Grantor Retained Annuity Trust
 - Sale funded by bank loan
 - Revenue shifting
- ✓ Cash value can help fund a lifetime buyout*
 - ✓ Cash value can provide asset diversification*
 - ✓ Carl can bonus Maria income to help pay premiums (162)

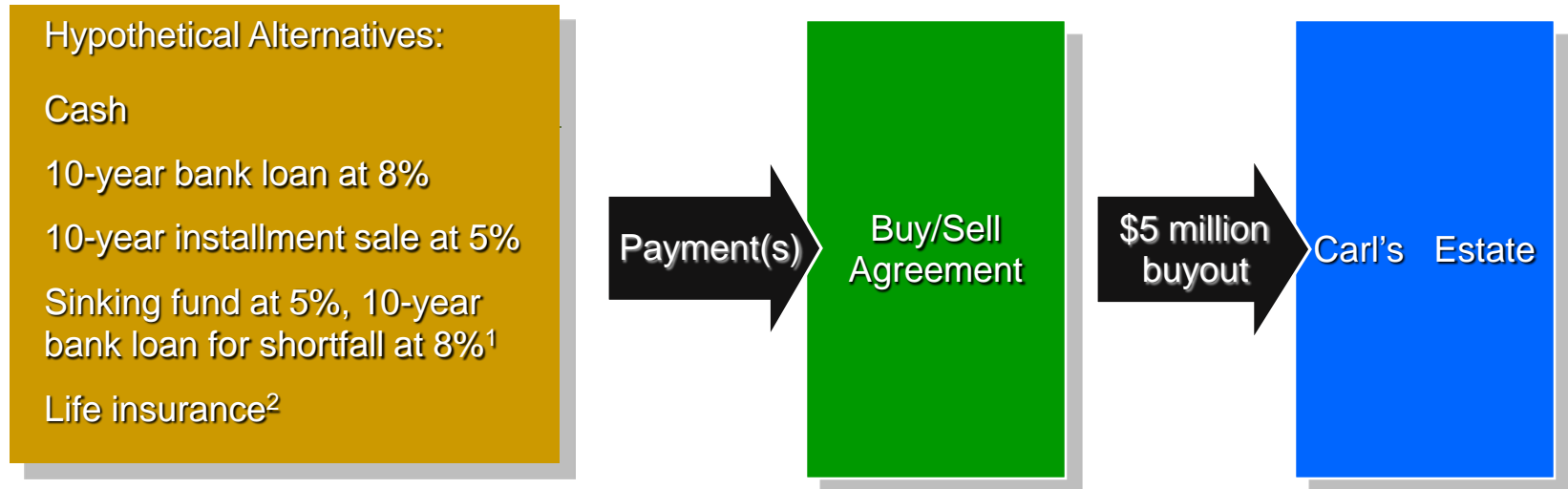
*Policy = Life Insurance Policy

*Both loans and withdrawals from a permanent life insurance policy may be subject to penalties and fees and, along with any accrued loan interest, will reduce the policy's account value and death benefit. Assuming a policy is not a Modified Endowment Contract (MEC), withdrawals are taxed only to the extent that they exceed the policyowner's cost basis in the policy and usually loans are free from current federal taxation. A policy loan could result in tax consequences if the policy lapses or is surrendered while a loan is outstanding. Distributions from MECs are subject to federal income tax to the extent of the gain in the policy and taxable distributions are subject to a 10% additional tax prior to age 59 1/2, with certain exceptions.

Strategies

Comparison of funding alternatives at death

Carl's Death: **Year 15 after policy issue**
Amount required for buyout: **\$5 million**



1. Amount contributed to the sinking fund is assumed to be equal to the premium on the life insurance policy, \$73,087 annually, growing at 5.82% net with a 10-year bank loan at a 8% interest rate utilized for any funding shortfall in year 15.
2. Hypothetical Product illustrated is the PruLife Founders Plus assuming a male, age 58, preferred non-nicotine, \$5 million face amount, \$73,087 level annual premium. Founders Plus is using a 5.82% illustrated rate. Total premiums paid by year 15 is \$1,096,305 or \$1.1M rounded.

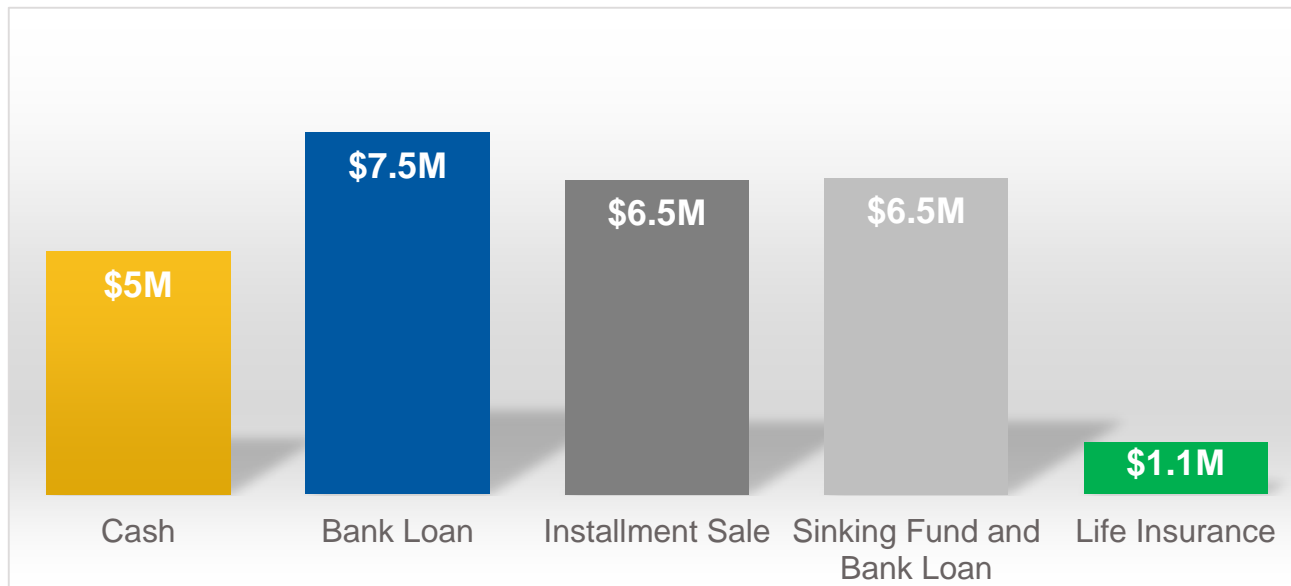
Options- Costs

Comparison of funding alternatives at death

Carl's Death: Year 15 after policy issue

Amount required for buyout: \$5 million

Total approximate projected costs at year 15



Based on the assumptions from slide 27. This is a supplemental illustration and it must be preceded or accompanied by a basic illustration. Please refer to the basic illustration for guaranteed values and other important policy information.

Options

Potential benefits to family:

- Liquidity for successor to buy business or pay estate tax
- Inheritance equalization for inactive children
- Orderly transition – purchase at a preset price
- Liquidity for surviving spouse to maintain lifestyle

Considerations:

- IRC § 2032, Special Use Valuation, or § 6166, Installment Payment of Estate Taxes may apply if estate meets the criteria
- Redemptions may be treated as dividends under family attribution rules with family businesses operated as corporations
- Key person strategies may be needed for managers/executives
- Family communication is critical

Getting Started

Client Profile- Create a List

- Family-owned businesses
- In business at least 5 years
- Positive cash flow
- Any type or entity
- Children actively involved

Succession Planning Steps:

- Obtain business valuation
- Proper titling of assets
- Structure the agreement
- Fund the agreement
- Coordinate overall estate

Key Question: Can I show you some ways to help ensure your family business stays in the family and survives beyond your death, disability, or retirement?

What We Covered Today



The Opportunity

- The Market

Planning Options

- Transfer Options

Getting Started

- Reaching out to Business Owners
- Let Us Help You

Important Information



PruLife Founders Plus UL, has the potential to build cash value in the Plus Account is based in part on the performance of the S&P 500® Index (using an index growth cap and floor) on an annual point-to-point basis based on a 50% participation rate (subject to change). Money that is placed in the Plus Account is not a direct investment in the S&P 500® Index.

The Index Growth Cap is generally stated as a percentage, which is the maximum rate of index interest that will be credited at the end of the one year Plus Account Segment, regardless of changes to the designated index. The Index Growth Cap is declared for each Plus Account Segment in advance of each Plus Account Segment start date. The Index Growth Cap may be raised or lowered at our discretion before the segment is created, but will not be lower than the guaranteed minimum index growth cap stated in the policy (3% in all states). Once a Plus Account Segment is created, its Index Growth Cap will not change. Changes to the Index Growth Cap could result in different values than shown here. Changes are not tied to the performance of the underlying index and may be based on interest rates, market volatility, and other factors. Index Growth Caps and Floors may be different in selected states.

The S&P 500® Index is a product of S&P Dow Jones Indices LLC (“SPDJI”), and has been licensed for use by The Prudential Insurance Company of America for itself and affiliates including Pruco Life Insurance Company and Pruco Life Insurance Company of New Jersey (collectively “Pruco Life”). Standard & Poor’s®, S&P®, and S&P 500® are registered trademarks of Standard & Poor’s Financial Services LLC (“S&P”); Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC (“Dow Jones”); and these trademarks have been licensed for use by SPDJI and sublicensed for certain purposes by Pruco Life. Pruco Life’s products are not sponsored, endorsed, sold or promoted by SPDJI, Dow Jones, S&P, or their respective affiliates and none of such parties make any representation regarding the advisability of purchasing such product(s) nor do they have any liability for any errors, omissions, or interruptions of the S&P 500® Index. S&P 500® index values are exclusive of dividends.

Thank You... Questions?

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