Guardian

Succession planning strategies for your business

As a small- or medium-sized business owner, you've already achieved success. But like so many other successful business owners, you're probably focused on sustaining what you've built — for both the present and the future. If you're like many, you have key employees you want to retain. And if you're turning your eye to the long term, you may worry about your ability to sell your company when you're ready, particularly if you have no relatives or partners who plan to take over someday.

If you can identify a potential buyer from among your key employees, implementing a Retention Bonus Agreement with a One-Way Buy-Sell Agreement may be a solution. It's an executive benefit strategy that can provide you with a viable business succession plan and give your key employee the means to purchase your business ownership interest.

How this executive benefit strategy works

- **Step 1 – The Retention Bonus Agreement:** Provides incentive to your key employee to stay with your company for a specified period of time — and is often funded with permanent life insurance.

  Funding this step with life insurance: With the key employee's permission, the business owner purchases a whole life insurance policy that is owned by the business and insures the key employee. If the key employee remains with the company after the time specified in the agreement (generally no more than 10 years), the key employee will receive, from the policy's cash value, a bonus that can be used to purchase the owner's share in the business.[1,2]

- **Step 2 – The One-Way Buy-Sell Agreement:** A contract that establishes the opportunity for your key employee to buy your business interest from you when you're ready to retire, or upon your death or disability. It, too, is commonly funded with life insurance.

  Funding this step with life insurance: The key executive buys a life insurance policy on the life of the business owner in an amount that would cover the payment obligations to buy the owner's business interest, and the company will provide an executive bonus to cover that cost. The policy will protect the key employee in case the owner dies before the retention bonus is paid.

- **Step 3 – Executing the buy-sell agreement:** Your key employee uses the retention bonus to help fund the purchase of your business interest, as stipulated in the buy-sell agreement.

The key to this strategy: The coordination of the executive benefit payout period with the triggering of the buy-sell, and adequate funding of the buy-sell.

What is a Retention Bonus Agreement?

In a Retention Bonus Agreement, the business agrees to pay the specified employee a bonus if the employee stays for an agreed-upon period of time or until a triggering event, such as the retirement, disability, or death of the owner. The employee will have more incentive to stay until the end of the period because otherwise, the employee will forfeit the bonus.

Steps 1 and 2 are completed at the **same** time.

What is a One-Way Buy-Sell Agreement?

A one-way, or unilateral, buy-sell agreement is a legal contract between the business owner and some third party addressing the disposition of the owner's business interest upon his or her death, disability, retirement, or other departure. It obligates the purchaser to buy out the interest of the deceased or departing owner. The departing owner, or estate of the deceased owner, is obligated to sell that ownership interest to the third party.

Step 3 takes place when the triggering event occurs.

Advantages and considerations: The Retention Bonus Agreement

- It can be an effective tool in overall succession planning.
- You decide which employees are offered a retention bonus.
- It can help your business retain key employees during a transition period.
- You and your key employee can negotiate both the bonus amount and the "stay" period. (Generally speaking, a retention period of more than 10 years may be too far into the future to be a meaningful benefit for your employee.)
- When the agreement is funded with permanent life insurance, your business has access to the policy's cash values.
- Life insurance premiums are not tax-deductible by the business.[3]
- The bonus is tax-deductible by your business when paid, as long as your employee's total compensation is reasonable. The bonus would be taxable income to your employee.

Advantages and considerations: The One-Way Buy-Sell Agreement

- It provides you and your family with assurance that a fair price will be paid for your business.
- The insurance premiums and growth provide the necessary cash to execute the buyout, without having to rely upon personal resources, credit, or cash flow.[4]
- You may wish to assist your key employee with life insurance premium payments, using deductible bonuses or other arrangements.
- The buy-sell agreement can establish "golden handcuffs" that can help your business retain key employees.
- The agreement creates a sense of stability for your customers, suppliers, bankers, and employees.
- Upon your death, the agreement may establish a fixed value for your business for federal estate tax purposes.

Protect your business today — and your bottom line tomorrow

Discover a strategy that can help you retain the key employees who are so important to the ongoing success of your business now, and in the years to come — while securing a buyer for your business when the time is right. Your Guardian financial professional can help you develop a strategy that can help you achieve both objectives, with funding strategies that won't strain your company's finances.

Contact your Guardian financial professional to start your strategy today.

1 Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses or is surrendered, any loans considered to be gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal is also subject to a 10% penalty tax.

2 Some whole life policies do not have cash values in the first two years of the policy and don't pay a dividend until the policy's third year. Talk to your financial representative and refer to your individual whole life policy illustration for more information.

3 Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

4 Dividends are not guaranteed. They are declared annually by Guardian's Board of Directors.

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