

# A Business Loan Insurance Plan

Are you personally responsible for business loans?

Prepared for: **Successful Business**

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## Do You Have to Sign Twice for Your Business Loans?

**For unincorporated businesses, the answer to this question is YES.**

Sole proprietors and partners are personally responsible for the repayment of business debt. This means that, to the extent that business assets are insufficient, personal assets must be used to repay outstanding business loans at the owner's death.

**While the liability of corporate shareholders is limited to their capital contributions, their answer to this question may still be YES.**

Since many creditors require that the owners of a closely-held corporation personally guarantee repayment of business debt, the shareholders' personal assets could be in jeopardy if an owner dies while a business loan is outstanding.

Even if corporate owners are not required to personally guarantee repayment of corporate debt, the availability of a commercial loan may depend on how much confidence the creditor has in the experience and management skill of the owners. Since that experience and skill vanish at an owner's death, **a creditor may require assurance that the loan will be repaid if the owner dies unexpectedly.**

## A Potential Solution Using Life Insurance

Purchase insurance on the owner's life in an amount equal to the outstanding business loan.

### A business loan insurance plan can accomplish the following:

- Payment is prompt and certain, meaning that life insurance proceeds are immediately available to repay any outstanding business debt at an owner's death.
- Generally, the life insurance proceeds are received income tax free.
- In the case of personally-guaranteed business debt, the owner's personal assets are protected and remain available to the surviving family.
- Any surviving owners are not burdened with repaying the business loan, making it easier to continue the business after the loss of the owner's skill and experience.
- Any proceeds not needed to repay the loan can be used to provide benefits to the deceased owner's family or to indemnify the business for the loss of the owner's skill and experience.
- Business loan insurance may make new or expanded lines of business credit available.

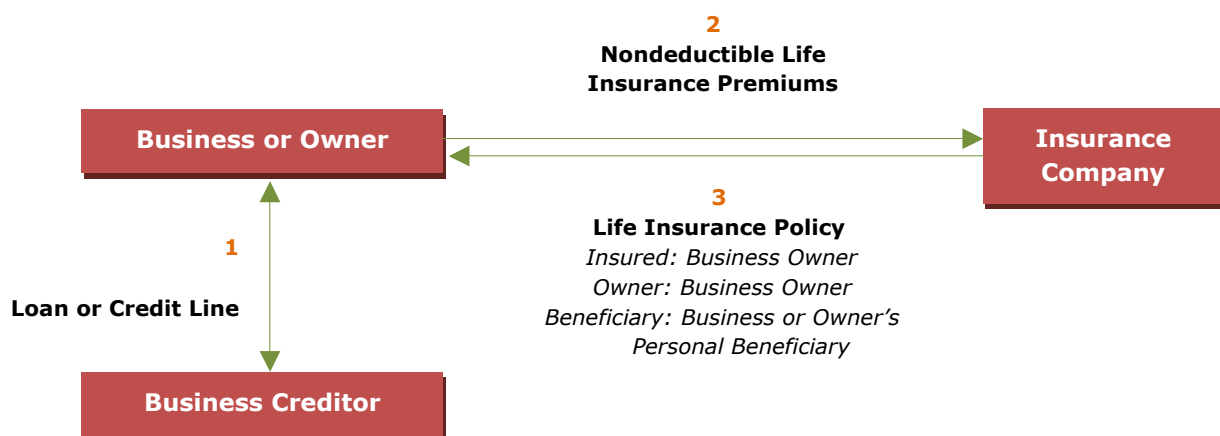
Only the life insurance solution can guarantee\* that the cash needed to repay outstanding business loans will be available exactly when needed -- at a business owner's death.

\* *Guarantee is based on the continued claims-paying ability of the insurer.*

## The Mechanics of a Business Loan Insurance Plan

The bottom line is that business loan insurance is an economical and efficient method of protecting business and, possibly, personal assets from business debt repayment requirements at an owner's death.

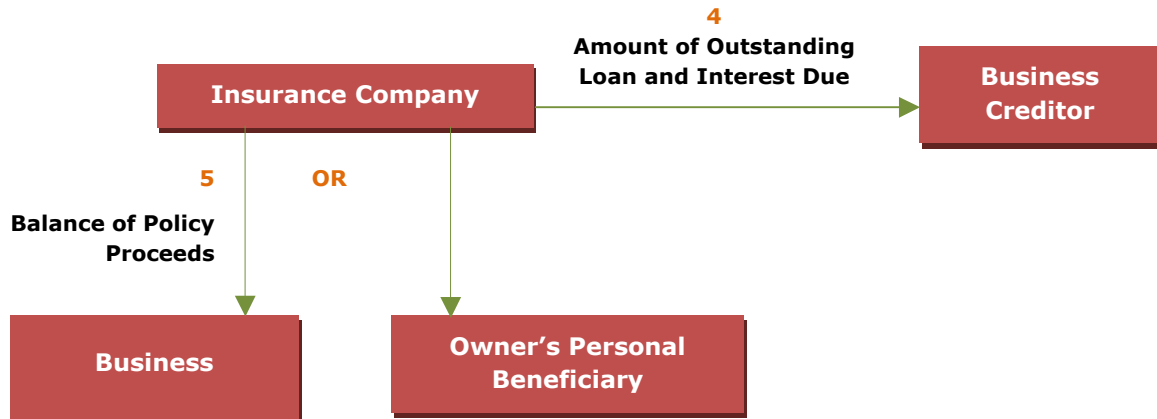
Here's how a business loan insurance plan could work for your business today...



- 1.** The business or business owner obtains a loan or arranges for an open credit line.
- 2.** The business or owner owns insurance on the owner's life in an amount approximately equal to the outstanding loan, and pays the nondeductible premiums. Either the business is named as beneficiary or the owner names a personal beneficiary, depending on who owns the policy.
- 3.** Many creditors require a collateral assignment of the policy to the creditor "as its interest may appear."

## The Mechanics of a Business Loan Insurance Plan

Here's how a business loan insurance plan could work at **the owner's death...**



4. At the owner's death, the income-tax-free policy proceeds are first used to repay the outstanding debt plus any interest due. Assuming the policy was assigned to the creditor, the payment is made directly from the insurance company to the creditor. Otherwise, the full proceeds will be paid to the named beneficiary and are then available for loan repayment purposes.
5. Any policy proceeds not needed for loan repayment purposes can be used by the beneficiary - the business or the owner's personal beneficiary - to satisfy financial needs that arise at the owner's death.

## The Value of Income Tax-Free Policy Proceeds

The value of life insurance policy proceeds received free of the regular corporate income tax can be significant, particularly as they relate to pre-tax profit equivalents.

For example, in a **28 %** tax bracket, **\$1,000,000** of income tax-free business loan insurance policy proceeds is equivalent to **\$1,388,889** of pre-tax profits!

### Ask yourself...

What amount of sales or receipts would your business have to generate in order to produce pre-tax profits of **\$1,388,889** ?

Profit Margin	Sales Required to Produce \$1,388,889 in Pre-Tax Profits*
10%	\$13,888,889
20%	\$6,944,444
30%	\$4,629,630

In other words, a **\$1,000,000** business loan insurance policy could be equivalent to **\$6,944,444** of sales or receipts that would otherwise have to be used to repay business debt, assuming that your business averages a **20%** profit margin!

*\* Pre-tax profits are equivalent to net sales or receipts before application of the regular income tax. Alternative minimum tax implications are not taken into account.*

## Summary of Business Loan Insurance Plan Tax Results

- Premiums paid for business loan insurance purposes are not deductible, regardless of who owns the policy and pays the premiums.
- Generally, life insurance proceeds received at the owner's death are not subject to the regular federal income tax.
- If the policy is owned by a corporation, any annual increase in the policy's cash value and the death proceeds may have corporate alternative minimum tax implications. Consult your professional tax advisor.
- To the degree that policy proceeds exceed the loan repayment, there may be some increase in the value of the business interest included in the deceased owner's estate, if the policy is owned by the business. If the policy is owned by the business owner, any excess death benefit would increase the value of the owner's estate.

## Business Loan Insurance Plan Action Checklist

### Now...

- Select the appropriate life insurance funding vehicle and policy ownership arrangement.
- Establish the owner's insurability.
- Arrange for payment of premiums.

### Short-Term...

- Draft and execute a corporate resolution authorizing the purchase of business loan insurance, if appropriate.
- Review the issued policy.
- Execute a collateral assignment, if required by the creditor.

### Longer-Term...

- An annual review can help ensure that the plan remains current.
- Evaluate business continuation planning needs, such as a buy-sell plan.

## Important Information

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