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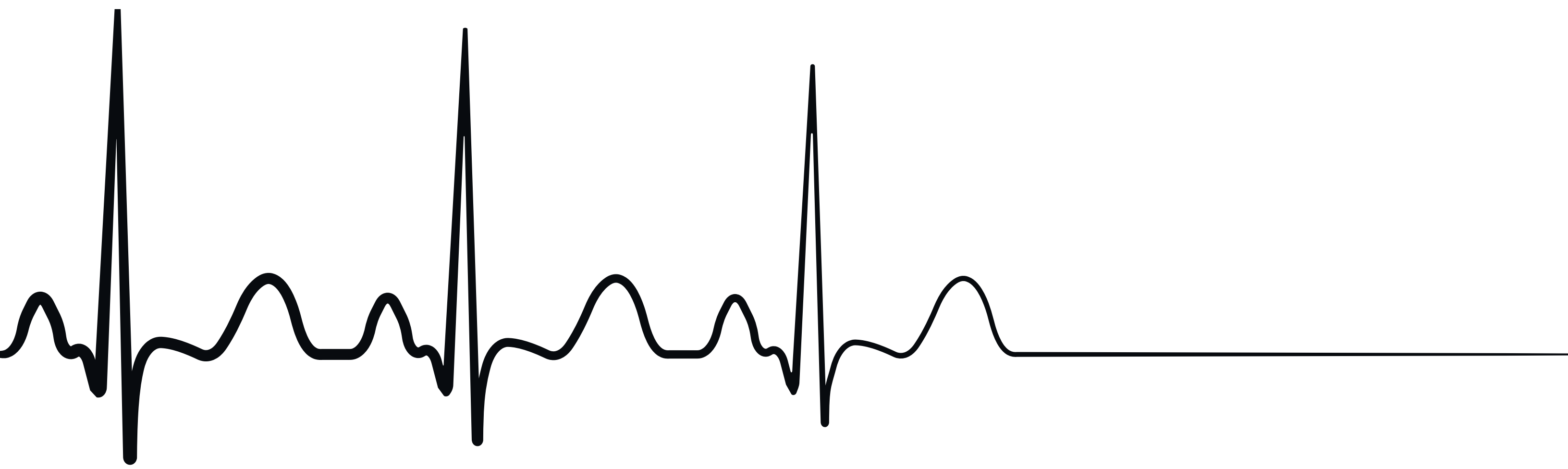
White Paper



What if Your Business Partner Died Tonight?

Most business owners probably spend more time with their business partner than their spouse.

The relationship between business partners (or, for that matter, co-owners of any closely-held company) is unique. In many respects, it's like a marriage — but more personal. Most business owners probably spend more time with their partner than their spouse. Ideally, your business partner is one of your business's greatest assets. But that person is also potentially your greatest liability.

If you don't agree, ask yourself a few key questions: What if my partner died tonight? What would happen to the business? What would happen to my family and my partner's family? These may not be the most pleasant questions, but they are ones you cannot afford to ignore.

BiA SMC
Building Industry Association of San Diego County
Sales & Marketing Council

For more info, please contact
April Gingras, SMC President

Phone: 858.414.2076
GoSMCSanDiego@gmail.com

www.biasandiego.org/membership/smc

A lifetime of work can dissolve into nothing in a few short months.

The loss of a business partner can be disastrous. A team member who is vital to the operations of the company is gone, along with his or her unique contribution. But that's only the beginning. Conflicts between the surviving owners and families of the deceased are fairly common, as everyone becomes concerned about the future.

Ongoing business problems result in further complications. As suppliers take a nervous 'wait-and-see' position, creditors may become anxious for payment and refuse to extend additional credit. Customers may back away. Valued employees may leave. Problems compound and feed on themselves.

What are your options?

If your business partner died tonight, you and the other survivors would have four choices —

1

Liquidate the business and distribute remaining assets. Unfortunately, this would eliminate a large source of income and dissolve a business enterprise in which you've invested a great deal of time and money. The business's assets would probably sell at a discount, potentially a steep one. The same scenario generally happens if your attempt to sell the business becomes an ongoing concern. Competitors love a bargain at your expense.

2

Take in your late partner's heirs as your new associates. Keep in mind that a successful partnership is a delicately balanced relationship. The right mix of personality and talent is hard to find — sometimes taking years to fine tune. Bringing someone in without in-depth knowledge of the business would likely have a negative impact.

3

Sell to the heirs. This also rarely works. Starting with an almost inevitable tug-of-war over the purchase price, the situation usually goes downhill from there. Other problems: Where would the heirs get the cash to make the purchase? Are they qualified to run the business? What would happen to you? Do you stay on as an employee, or sell your own job?

4

Buy the surviving heirs' share of the business. This, in most cases, is the most practical course of action. Once again, however, there are the problems of establishing price and terms, as well as coming up with the money.

An Ideal Solution

When considering the options, the ideal solution is one that:

- ✔ **Gives** control of the business to the surviving active owner(s).
- ✔ **Provides** fairly and adequately for the deceased's family members.
- ✔ **Does not impose** a financial burden on the business.
- ✔ **Provides** a fair, objective means to value the deceased partner's share of the business**.**
- ✔ **Prevents** legal hassles and feelings of bad faith.

For most business owners, a solution that meets all those objectives is a properly funded buy/sell agreement.

Getting Familiar with Buy/Sell Agreements

The buy/sell concept is simple: A properly arranged and funded agreement is a legally binding contract that spells out exactly what is to happen if one of the business owners dies or becomes disabled. The document itself can be as simple or complex as needed and can provide for many contingencies. However, it generally calls for the survivors to buy — and the heirs to sell — the deceased owner's share in the business. Just as important, it should spell out the actual purchase price or, more commonly, provide an objective formula for determining the price when needed. This eliminates price haggling — the biggest source of conflict among survivors.

This type of agreement can be drafted by a qualifying attorney to meet the needs of all parties by providing needed cash and enabling the company to survive during the difficult transition period.

Adequately funding the agreement

The buy/sell agreement is worth nothing without the money to execute it. This may require hundreds of thousands — possibly even millions — of dollars. There are four possible funding options:

1. **Set up a sinking fund**, and pay into it over time. ***Drawbacks:*** *Few businesses have the resources to set aside these funds. Plus, the amount would be inadequate if a death occurs too early.*

2. **Borrow the money** at the time of death. ***Drawback:*** *Few institutions would lend money to a company in which a principal owner recently died.*

3. **Make installment payments** to the heirs, buying out the deceased partner's share over time. ***Drawback:*** *Such payments could further damage an already financially weakened company. Imagine continuing to pay a deceased partner's salary for the next 20 years, but getting no return on those payments.*

4. **Life insurance**. Historically, cash value life insurance has been used as an effective funding option, allowing partners to carry adequate insurance on each other.

The life insurance advantage

The advantages of cash value life insurance as a buy/sell funding vehicle include the following:

1. Proceeds are delivered at the exact moment they are needed most, providing necessary cash to fund the agreement.

2. Under most circumstances, proceeds are received by the beneficiary income tax-free.

3. The cost can be minimal compared to other methods. The policyowner buys future funds with discounted dollars in the form of scheduled premium payments.

4. Cash values accrue within the policy on a tax-advantaged basis. Should all parties live to retirement, these cash values can be used for a buy-out or to supplement other retirement income. Policy loans and withdrawals may create an adverse tax result in the event of a lapse or policy surrender, and will reduce both the cash value and death benefit.

5. Life insurance products contain fees, such as mortality and expense charges, and may contain restrictions, such as surrender periods.

An insurance buy/sell agreement can help solve business succession issues for you, your business associates and families. As with any business decisions, discuss your options with your partners, legal counsel and stake holders.

Stephanie Hughes
Financial Strategist
License # 0I98528
Tax & Financial Group

5720 Oberlin Drive, Suite 138
San Diego, CA 92121

Office: 858.200.1972
Direct: 831.224.4489
Fax: 949.223.8101

Stephanie.Hughes@tfgroup.com
www.tfgroup.com

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Stephanie received her Bachelor of Science Degree in Liberal Studies with a Major emphasis in Spanish and Minor in Chemistry and Pre-Medicine Studies from the University of California at Riverside. Stephanie holds the Series 7, 63, and 65 registrations, Life and Health Insurance Licenses, as well as variable life and annuity licenses. Stephanie is a Registered Representative and Investment Advisor Representative of Securian Financial Services, Inc., member FINRA/SIPC.

Stephanie is fluent in Spanish, and has many professional achievements; one most noted is being awarded the "Rob Roy Integrity Award" from UCR in 2002.

She is a member of the Building Industry Association of San Diego as well an active member of the Southern California Trade Association. She has taken a particular interest in the Women in Biosciences organization in San Diego and supporting women business owners and entrepreneurs.

We're looking for experts like you!

Have a whitepaper you'd like to share or write for the SMC? Contact our White Paper Committee Chair directly, Lori Asaro at lori.asaro@gmail.com and cc smc@biasandiego.org and provide your name, contact information, and subject matter for consideration.

- Don't worry about formatting, we'll do that for you.
- Write about something you know.
- It should be educational, but still engaging.
- 1,000 words is ideal for this purpose.
- Provide citations if referencing other material.
- Provide links.
- Add pictures.
- Provide a Bio and your picture.

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