



Business Succession Planning Needed More Now Than Ever

According to the U.S. Small Business Administration, there are over 33 million small businesses representing over 99% of all businesses in the U.S.ⁱ Small business owners are in need of business succession and continuity planning advice, now more than ever. After all, the business can often be the greatest asset that the owner may have, and it certainly is the cash flow engine that helps to support their family's lifestyle. Indeed, it is estimated that 80 to 90% of small business owners have most of their net worth tied up in their business.ⁱⁱ However, only 34% of business owners recently surveyed said they had a robust, documented and communicated succession plan in place.ⁱⁱⁱ

In a different survey, 70% of surveyed owners also indicated that they needed to harvest the value of their business to support their lifestyle post-exit.^{iv} Succession planning may help to monetize the business to ensure a retirement fund for the owner and his/her family. Planning strategies may include buy-sell agreements funded with life insurance and disability buy-out insurance, covering catastrophic events such as the death or disability of the owner. Installment purchase agreements may be used to address a business owner willingly departing or forced out of a business due to divorce, retirement, bankruptcy, disagreements with co-owners, or other events. Installment agreements may also be used to transfer a business while maintaining an income for the departing owner through the installment payments.

For family-owned businesses, succession planning allows the senior generation to pass on a legacy to younger generations. Often, the transfer of a business to the next generation involves gifting strategies such as outright gifts, grantor retained annuity trusts, sales to intentionally defective grantor trusts and more. Bequests and post-mortem trusts may also be used to transfer the business. Strategies may also include the typical buy-sell agreements or installment purchase agreements if the senior generation desires the younger generation to "earn" or buy-out the business rather than receiving it as a lifetime or testamentary gift. Often, it is a combination of strategies.

Remember that for family businesses, when there are multiple children and not all are actively involved in the business, it is rarely wise to give the business in equal shares including uninvolved children. That can create disagreements, acrimony, jealousy and other adverse impacts among family members. Instead, the legacy for uninvolved children can be through other family assets or cash. Life insurance is often used as a wealth equalization tool to create a pool of cash.

Consideration must also be given to the “sunset” of the federal estate tax exemption at the end of 2025, and a recent U.S. Supreme Court case that has turned once well-settled business succession doctrine on its head and outlined as follows.

The current federal estate and gift tax exemption amount for 2024 is \$13.61 million per person. The Tax Cuts and Jobs Act of 2017 (“TCJA”)^v doubled the exemption amount at that time of \$5 million to \$10 million, adjusted annually for inflation per person. Married couples can pass double that amount without transfer taxes. However, the doubled exemption amount will expire at the end of 2025, causing the exemption to revert back to \$5 million plus inflation adjustments in 2026. After the 2024 elections, if the Presidency and both houses of Congress become controlled by Democrats, then it is quite possible for the exemption to be reduced even further. Business owners who once never gave a second thought to the federal estate and gift tax may now have to, particularly if the business is valued over the halved exemption amount. The various gifting strategies and bequests mentioned previously will all be impacted by the reduced estate and gift tax exemption and potential tax exposure.

On June 6, 2024, the U.S. Supreme Court decided the *Connelly* case that reversed generally accepted principles long held by the insurance and legal communities.^{vi} The Court addressed the narrow question of whether a corporation’s fair market value for estate tax purposes is impacted by life insurance proceeds received by the corporation and committed to funding the redemption of a decedent owner’s shares. The Court unanimously held that the corporation’s redemption obligation is not a liability that reduces the estate tax value of the decedent’s shares. Therefore, the life insurance proceeds in an entity redemption agreement **increases** the value of the business for estate tax purposes. With the looming sunset of the federal estate tax exemption, business owners with stock redemption or entity redemption buy-sell agreements funded with life insurance need to further consider the estate tax impact of those agreements.

Connelly, cited above, has created a situation where business owners with life insurance funded entity redemption agreements may have a tax situation that wasn’t there before. The sunset of the federal estate tax exemption exacerbates that problem even more. The Court specifically referenced that cross-purchase buy-sell arrangements could have avoided this result. Therefore, buy-sell agreements may need to be revised and amended. Estate plans must be reviewed and amended if the *Connelly* decision created an estate tax issue. More sophisticated techniques may need to be used if a typical cross-purchase agreement is impractical, such as the creation and use of a Special Purpose or Insurance Only LLC to own the life insurance policies to be used in a cross-purchase arrangement.

Clearly, it has never been a more important time to consider business succession planning for small business owners. Planning is vital to ensure that business owners maximize the liquid value of their business interest, and to create or enhance their retirement income. Business owners also need to ensure that their plan helps to minimize potential estate tax issues while securing their financial security and family legacy.



Contact your Security Mutual Life insurance advisor today to review your situation. Your Security Mutual Life insurance advisor is positioned to help you by working with your tax and legal advisors to create an insurance plan designed to fit your financial, business and estate planning goals.

For More Information Contact:



ⁱU.S. Small Business Administration Office of Advocacy. "2022 Small Business Profile." Sba.gov. <https://advocacy.sba.gov/wp-content/uploads/2022/08/Small-Business-Economic-Profile-US.pdf> (accessed August 24, 2024)

ⁱⁱMunk, Cheryl Winokur. "The biggest mistakes owners make when selling their business." Cnbc.com. <https://www.cnbc.com/2022/12/29/the-biggest-mistakes-owners-make-when-selling-their-business.html#:~:text=80%25%20to%2090%25%20of%20business,consider%20when%20selling%20their%20business> (accessed August 24, 2024). See also, Nicholson, Dan. "Do You Know Your Business Net Worth?" Certainty News. certaintynews.com/article/do-you-know-your-business-net-worth-2 (accessed October 14, 2024).

ⁱⁱⁱPricewaterhouseCoopers. "PwC's 2023 US Family Business Survey." Pwc.com. <https://www.pwc.com/us/en/services/audit-assurance/private-company-services/library/family-business-survey.html> (accessed August 24, 2024)

^{iv}Exit Planning Institute. "2023 National State of Owner Readiness Report." Exit-planning-institute.org. <https://exit-planning-institute.org/2023-national-state-of-owner-readiness> (accessed August 24, 2024)

^vStatute at Large 131 Stat. 2054 - Public Law No. 115-97 (12/22/2017)

^{vi}*Connelly v. United States*, 602 U.S. ____ (2024).

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