START-UP COMPANY WITH INSURANCE NEEDS

SHAREHOLDER AGREEMENTS, LIFE INSURANCE TRUST, DIFFICULT JUSTIFICATION OF DEATH BENEFITS



Recently a Marcum LLP CPA engaged us to review the insurance needs for a startup company. The company has 4 partners and no revenue to date. They have a shareholder agreement that states if any individual shareholder or principal dies, the surviving shareholders shall purchase no less than 100% of the shares from the deceased shareholder's estate. It also states a mandate that the company must maintain such coverage, in good standing at all times.

Upon the initial discussion with the CFO, we noticed the shareholder agreement did not mention what happens at the event of disability of a shareholder. They found this to be both important and missing so the agreement will be amended to refl ect this need. This coverage is placed through Lloyds of London and provides a lump sum benefit of $10,000,000 in the event of permanent disability with a 12 month elimination period.

A buy/sell agreement can be structured in a number of ways. Traditionally, each partner owns a policy on each other. This is referred to as a cross purchase. The benefit is the purchasing owner receives a step up in basis because they are purchasing the shares at the new valuation. The drawback is that partnerships of 3 or more require many policies. In the case of 4 partners, each will own 3 policies for a total of 12 policies. Traditionally an entity purchase would be established in this scenario. An entity purchase is where the business owns the policies. At death the surviving shareholders receive a reverse delusion of shares but do not receive a stepped up basis. Our solution was to recommend an Insurance LLC. This is the best of both worlds, enjoying simplicity of a single policy on each owner and a step up in basis.

Below are the insurance designs recommended. They are 20 year, guaranteed convertible term insurance with optional disability buyout.

	Key Man Life Insurance for the Shareholder Buyout Provisions				Key Man Disability Buyout		
	Death Benefit	Premium Preferred (Low)	Premium Standard (High)	Life Insurance Buy/Sell Premium Average	Lump Sum Disability Payout	Disability Buyout Premium	Combined Total
Partner 1	10,000,000	$ 5,970	$ 9,450	$ 7,710	$ 10,000,000	$ 21,662	$ 29,372
Partner 2	10,000,000	27,110	44,790	35,950	10,000,000	59,682	95,632
Partner 3	10,000,000	33,330	56,060	44,695	10,000,000	70,813	115,508
Partner 4	10,000,000	$ 20,420	$ 32,310	$ 26,365	$ 10,000,000	$ 46,825	$ 73,190
			Sum	$ 114,720		$ 198,982	$ 313,702

A properly designed buy/sell plan starts with the legal agreement and is nearly always funded with insurance. If a partner dies, the benefit is the spouse of the deceased partner has immediate cash in the amount in the share of the business ownership. The benefit of the surviving owners is they cleanly absorb the shares of the deceased owner and have no further obligations to the family of the deceased owner.

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