Business Solutions Playbook

Uncover Missed Planning and Life Insurance Opportunities With Your Business Clients

Pacific Life Insurance Company

As a result of offering products and services such as 401(k)s, employee benefits, or commercial property and casualty coverage, businesses may comprise a significant portion of your book of business. One of the primary benefits of working with businesses is that they have multiple needs, and thus, there are a multitude of potential planning opportunities available. Are you properly servicing your existing business clients and addressing all of their various needs?

Too many financial, insurance, and benefits advisors leave opportunities on the table when it comes to their business clients. When considering that it is far easier to cross-sell an existing client than to constantly have to find a pipeline of new clients, doesn't it make sense to broaden your planning services to better address the needs of your existing business clients? These potential planning needs may include:

- Supplemental retirement planning for the business owner and/or key executives
- Business succession planning
- Estate planning for the business owner
- Key person protection for the business

This Business Solutions Playbook is designed to help you uncover these missed potential planning opportunities with your existing business clients with whom you have done or are doing 401(k), employee benefits, commercial property and casualty, or other business. This Playbook will provide you with relevant and thought-provoking questions to ask the business owner or other decision maker in the business to uncover concerns and needs, and present potential planning opportunities that would have otherwise been left on the table, based on the client's concerns and business industry considerations. While its primary purpose is death benefit protection, life insurance may be able to play an important role in helping to address the planning needs of the client.

Do you know if your client has considered and answered the crucial business planning questions?

- How can I ensure that my business will continue to thrive when I'm not around?
- How do I successfully transition the ownership of the business?
- How do I ensure that I retain my valuable employees who are key to maintaining and growing the value of my business? How do I protect the business should something happen to him or her?
- How can I enjoy a comfortable retirement?
- How will the business provide for my family if something should happen to me?
- How do I treat my children fairly?

How to Begin the Conversation With Your Business Clients:

Some preliminary points and questions to get the conversation of potential additional planning needs started:

- While we have already completed some planning for you by establishing a 401(k), I want to be sure to provide a holistic approach to your planning and make sure to address all of your planning needs as a business owner.
- There are many planning aspects that we have not yet discussed and I want to address all of your needs to ensure that we are not missing any areas that could cause potential issues/planning concerns down the line if not addressed early on.
- As a business owner, there are many planning needs that are often missed and can have unforeseen and potentially catastrophic consequences if not planned for appropriately.
- As your financial/insurance/benefits advisor, I want to make sure that I am able to identify and address your potential planning concerns.

Client Needs Analysis

Where to Start: Pertinent Questions for Every Business Owner:

I. General Business Information *(You may skip the questions in this section if the client has previously provided you with this information.)*

A. How is your business classified for federal tax purposes?

○ C-Corporation ○ S-Corporation ○ Partnership ○ Disregarded Entity / Sole Proprietorship

B. What is the nature of the activity of your business (i.e. manufacturing, professional services, technology, etc.)? ____________________

____

C. What percentage of the business do you own? ____________________

- If less than 100%, how many other owners are there and what percentage of the business do each of them own? ____________

  ____

D. How many employees does your business have?____________________

II. Protecting the Business Against the Loss of Key Employees

A. Are there any individuals, including yourself, whose loss (if the individual voluntarily left or died) would pose a significant financial hardship to the business? ○ Yes ○ No

- If yes, has your business taken any steps to protect itself financially in the event of the death of one of these key employees? ○ Yes ○ No
- If yes, has your business implemented strategies that are having a meaningful impact on retaining your key employee(s)? ○ Yes ○ No

III. Business Succession Planning

A. Do you currently have a formal plan in place? ○ Yes ○ No

- If yes, does it reflect your current goals regarding how you would ideally like to exit your business? ○ Yes ○ No

IV. Retirement Planning

A. Do you have adequate retirement assets other than the business so that you're not so reliant on the business as your source of retirement income? ○ Yes ○ No

B. If you currently participate in a qualified plan, have you accounted for the income tax impact upon the distribution of your qualified plan retirement income and the potential retirement shortfall this may create? ○ Yes ○ No

V. Estate Planning

A. Is your estate large enough that you may be subject to federal or state estate taxes upon your death? ○ Yes ○ No

- If yes, do you have adequate liquidity so that estate taxes would not adversely impact your ability to pass on your business to your heirs? ○ Yes ○ No

B. Do you have non-business heirs that you want to ensure are treated fairly as part of your estate plan? ○ Yes ○ No

- If yes, do you have adequate non-business assets to accomplish your goal of treating them fairly? ○ Yes ○ No

C. Is your business the primary source of financial support for your family? ○ Yes ○ No

- If yes, if something were to unexpectedly happen to you, do you feel confident that your family will be provided for? ○ Yes ○ No

Listed below are the potential planning concerns covered in the questions above. Using the chart below, you can identify your client's areas of top planning concerns. In column 1, please check which areas of concerns the client indicated "No." In column 2, check the one(s) the client has identified as his/her primary need(s).

Potential Areas of Concern	Check if a "No" Response	Top Concern(s)?
I. Business is Protected Against the Loss of Key Employees		
• Business is protected against the death of a key employee		
• Business has implemented a plan to retain key employee(s)		
II. Business Succession Planning		
• Client has a plan in place that reflects current goals to transfer or transition the business		
III. Retirement Planning		
• Client has adequate retirement assets		
IV. Estate Planning		
• Client has adequate liquidity to pay for estate taxes		
• Client has non-business assets to treat non-business heirs fairly		
• Client's family will be adequately provided for in the event of his/her death		

Client Profiles & Potential Planning Strategies

Once you have identified a Planning Area of Concern for your client, it is important to then understand which facts are applicable to your client to help narrow down which type of strategy may be the most appropriate. On the following pages, use the Business Owner Characteristics in the left column to identify those which reflect your client. For each Business Owner Characteristic which is applicable to your client, consider the corresponding Strategies in the right column. Some of these strategies are illustrated in the Case Studies in this Playbook. For additional details on each these strategies, please see Pacific Life's additional marketing materials, such as our It's All About the Business brochure.

Primary Area of Concern(s) Is Business Succession

Business Owner Characteristics	Strategies to Consider
The client's business has multiple owners, and the owners would like to sell their interests to each other.	*Entity Purchase Buy-Sell* *Cross-Purchase Buy-Sell*
The client's business has multiple owners, the owners are partners in any partnership or limited liability company taxed as a partnership, and the owners would like to sell their interests to each other, but they also have a need for supplemental retirement income.	*Insured Controlled Cross-Purchase*
The client's business has multiple owners, and the owners would like to sell their interests to each other, but want flexibility as to how the purchase is ultimately handled.	*Wait-and-See Buy-Sell*
The client's business has multiple owners and the client wants to sell his or her interest to one or more co-owners, but there is no mutual intent to sell on their part.	*One-Way Buy-Sell* *Entity Redemption Buy-Sell*
The client's business has multiple owners and one owner would like to sell his or her interest to one or more co-owners, but there is no mutual intent to sell on their part. The client would like flexibility as to how the purchase is ultimately handled.	*Wait-and-See Buy-Sell*
The client would like to sell his or her business interest to a non-owner, such as a key employee, family member or third party.	*Supplemental Executive Retirement Plan (SERP) Buy-Out* *One-Way Buy-Sell*

Primary Area of Concern(s) Is Protecting the Business Against the Loss of a Key Employee

Business Owner Characteristics	Strategies to Consider
The client would like to preserve the value of his or her business and keep it thriving for many years by incentivizing his or her key employees to remain with the business.	*Executive Bonus* *Split Premium Bonus* *Restricted Executive Bonus* *Nonqualified Deferred Compensation Plan* *Split Dollar (Endorsement)* *Split Dollar (Loan Regime))*
The client would like to protect his or her business in the event of the premature death of one or more key executives.	*Key Person Life Insurance*

Primary Area of Concern(s) Is Retirement Planning

Business Owner Characteristics	Strategies to Consider
The client's business currently has an existing qualified retirement plan with matching contributions. The client's business does not currently offer a qualified retirement plan, but the client has a small business with relatively few non-owner employees.	*Split-Funded Defined Benefit Plan* *Life Insurance for Supplemental Retirement Income*
My business employs more than a few employees and does not currently offer a qualified retirement plan.	*Life Insurance for Supplemental Retirement Income*

Primary Area of Concern(s) Is Estate Planning

Business Owner Characteristics	Strategies to Consider
The client would like his or her estate to have sufficient liquidity so that estate taxes[6] and other costs do not adversely impact the business or his or her succession or exit plan.	*Estate Liquidity Planning Using an Entity Redemption* *Irrevocable Life Insurance Trust*
The client would like his or her family to be taken care of upon his or her death without being dependent upon the continued success or disposition of the business.	*Irrevocable Life Insurance Trust* *Personally-Owned Life Insurance*
The client would like to ensure that any non-business heirs are treated fairly.	*Irrevocable Life Insurance Trust* *Personally-Owned Life Insurance* *Estate Liquidity Planning Using an Entity Redemption*

What Are the Business Owner's Concerns?	How Life Insurance Can Help
The client wants to sell his or her business eventually. • How can the client successfully sell his or her interest in the business during his or her lifetime or at death to a family member, co-owner, third party or employee(s)?	• *Death benefit provides funds to purchase the client's business interest at death. Cash value acts as a tax-deferred sinking fund for purposes of purchasing the client's business interest during lifetime.*
The client's business is highly dependent upon one or more key employees. • How can the client ensure the continued success of his or her business throughout the transition process? • How can the client make sure his or her business continues to succeed if the business loses a key employee?	• *Cash value can be used to informally fund an executive benefit plan to help the client retain key employees essential to the continued success of his or her business.* • *Death benefit provides funds to help the client's business recover from the death of a key employee.* • *Death benefit provides funds to pay off business debt that may otherwise be called, and to ensure that the business is more financially secure.*
The client wants to make sure that he or she has a comfortable retirement. • How can the client secure a retirement that is less dependent on the continued success of the business and/or the disposition of his or her interest in the business?	• *Cash value can provide a potential source of supplemental retirement income so that the client and his or her family are not as dependent upon the business for retirement income.* • *Death benefit can address a short-fall in retirement income for a surviving spouse should the client die prematurely.*
The client wants to provide financially for his or her family and protect the business in the event of his or her death. • How can the client provide for his or her family independent of the continued success of the business? • How does the client treat his or her non-business heirs fairly? • How does the client make sure that estate taxes do not adversely impact the business?	• *Death benefit provides funds for the client's family so that they aren't dependent upon the continued success of the business after his or her death.* • *Death benefit provides funds to treat children not involved in the family business fairly.* • *Death benefit provides funds to pay estate taxes[1] to make sure the client's business doesn't need to be sold and that it passes intact to his or her children.*

1 According to the Tax Cuts and Jobs Act of 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are all $10,000,000 per person (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%. In 2026, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are scheduled to revert to $5,000,000 per person (indexed for inflation for tax years after 2011).

Life insurance is subject to underwriting and approval of the application and will incur monthly policy charges.

Industry Considerations

Depending on the type of industry that your client's business is in, there may be additional considerations that may help emphasize and identify some potential planning concerns and needs. While many of the planning strategies discussed in this Playbook are applicable across all industries, the nature of certain industries may make specific strategies more applicable to those industries than others.

PROFESSIONAL SERVICES

Common Types of Professional Services:

- Healthcare/Physicians
- Certified Public Accountants (CPAs)
- Attorneys
- Financial Services
- Consultants
- Architecture Firms
- Real Estate Brokers

Common Considerations & Potential Opportunities:

- Does the client have a plan for funding retirement outside of the value of the business?
  - *Potential Life Insurance for Supplemental Retirement Income Opportunity*
- Does the client have any partners in their business to whom they would sell their interest when they retire or pass away?
  - *Potential Buy-Sell Opportunity*
- Is the client's business structured as a pass-through entity (partnership, S-corporation, LLC, sole proprietorship)?
  - *Potential 199A Deduction/Split-Funded Defined Benefit Plan Opportunity*

Since many professional services are based on the reputation or skill of the business owner, unless they are selling their book of business to a co-partner or successor in the business practicing the same profession, many times those in professional services may have a more difficult time selling their businesses to an outside individual if they are the sole owner of the business. This may be problematic if the owner is counting on the proceeds from the sale of the business being the primary source of retirement funds.

Additionally, many professional service businesses are organized as pass-through entities. With the creation of Internal Revenue Code Section 199A ("199A"), there is a potential deduction for business owners of pass-through entities. However, if the business is deemed to be a "Specified Service Trade or Business" ("SSTB"), which most of the above listed professional service business are classified as (with the exception of real estate brokers and architecture firms), then in order to qualified for the deduction, the business owner's total taxable income must fall under a certain amount.[2] Implementing a Split-Funded Defined Benefit Plan may create a large tax deduction, which may help the business owner to qualify for this deduction.

See Supplemental Retirement Income Case Study (pg. 14)

2 IRC Sec. 199A

TECHNOLOGY

Common Types of Technology Companies:

- E-Commerce/Marketplace
- Technology Hardware
- Technology Software
- Application Development

Common Considerations & Potential Opportunities:

- Does the client's business have an employee that plays a crucial role in the success of the business, such that the business would suffer financial loss or hardship should it lose that employee?
    - *Potential Key Person Opportunity*
- Does the client's business offer competitive and incentivizing executive benefits to the employee(s) that are key to the success of the business?
    - *Potential Executive Bonus or Non-Qualified Deferred Compensation Plan Opportunity*

With the technology industry growing faster than most other industries, there is a constant demand for capable engineers, programmers and coders in technology companies. Recruiting and maintaining key employees in the technology industry is critical for those companies to stay competitive. For this reason, executive benefits and key person protection are extremely important in this industry. Additionally, since many in the technology industry are young and owners often move from start-up to start-up, buy-sell planning funded with cash value life insurance is necessary for a lifetime buy-out.

See Key Person Protection Case Study (pg. 19) &
Executive Benefits Case Study (pg. 17)

MANUFACTURING

Common Subsectors of Manufacturing:

- Transportation Equipment
- Food
- Fabricated Metal Products
- Machinery
- Chemical
- Plastics and Rubber
- Printing and related support activities

Common Considerations & Potential Opportunities:

- Does the client's business offer competitive and incentivizing executive benefits to its key executives?
  - *Potential Executive Bonus or Non-Qualified Deferred Compensation Plan Opportunity*
- Does the client have an identified successor and a plan in place for the transition of the business to that individual?
  - *Potential Buy-Sell Opportunity*

Businesses in the manufacturing industry usually have a large number of rank-and-file employees, but the success of the company is based on a select few that have the operational and managerial skills. As such, retaining the key executives can be crucial, either through a Non-Qualified Deferred Compensation Plan or another type of Executive Benefit plan, such as an Executive Bonus arrangement.

Additionally, since manufacturing companies may survive for generations, proper succession planning can be a key concern.

See Business Succession Case Study (pg. 17)
& Executive Benefits Case Study (pg. 21)

NON-PROFIT

Common Types of Non-Profits:

- Public Charities
- Community Foundations
- Religious Organizations & Institutions
- Educational Organizations & Institutions
- Donor-Advised Funds
- Private Foundations

Common Considerations & Potential Opportunities:

- Would the non-profit be able to continue to run successfully and maintain and/or grow its level of fundraising should it lose a key employee that serves in such a role?
  - *Potential Key Person Opportunity*
- Does the non-profit offer competitive and incentivizing executive benefits to the employee(s) that are key to the fundraising and/or running of the non-profit?
  - *Potential Executive Bonus or Loan Regime Split-Dollar Opportunity*

Non-Profits are tax-exempt entities under federal and state law. Since they are tax-exempt, potential tax deductions for the business will not play a factor in planning considerations as it may with a for-profit business. However, non-profits have many of the same goals and concerns as other types of businesses when it comes to key person protection and providing executive benefits to protect against the loss of important employees.

While there are certain types of Non-Qualified Deferred Compensation (NQDC) plans that can be offered by non-profits, known as 457(f) plans, as a result of Section 4960 of the Internal Revenue Code created by the 2017 Tax Cuts and Jobs Act, for any of the non-profit's five highest-paid employees, should they receive compensation of more than $1 million from the non-profit in a year,[3] which could happen upon the "vesting" of a 457(f) plan at an event such as that employee's retirement, a 21% excise would be imposed upon the non-profit on the amount of compensation in excess of $1 million.

As such, to avoid this potential 21% excise tax, an Executive Bonus Arrangement, whereby the executive benefit is provided to the employee each year, rather than all in one lump sum at an event such as retirement, may be a more favorable and administratively simpler option to reward and retain key employees. An additional, but slightly more complex, option may be to put a Loan Regime Split-Dollar arrangement in place.

See Key Person Protection Case Study (pg. 19)
& Executive Benefits Case Study (pg. 17)

3 IRC Sec. 4960

Case Studies – Popular Business Owner Strategies

The following hypothetical case studies illustrate some of the most common fact patterns involving business owners and the more popular strategies that may be fitting for your business clients.

CASE STUDY: SUPPLEMENTAL RETIREMENT INCOME

SITUATION:

Larry, age 50, is the owner of Pages Consulting, a consulting firm that specializes in working with bookstores. Larry enjoys his work, but he has always envisioned selling the business and retiring at 65 to travel the world with his wife. Throughout the years, Larry was able to take on more and more clients and grow Pages Consulting each year. However, in the past few years, many of Larry's current and potential clients without online retail have sadly gone out of business due to the popularity of online bookstores and electronic books. Although Pages Consulting has been able to broaden its services somewhat to prevent significant financial losses up to this point, the business is no longer growing at the rate it once was and the profit margin has decreased each year over the past few years.

CHALLENGE:

Larry worries that due to Pages Consulting not doing as well the past few years, the value of the business likely will not be as much as he had originally expected it would be ten years from now, when he plans to sell it and retire. As a result, he fears he will not have as much for he and his wife to live off and be able to travel during retirement as he originally expected. Although Larry was smart to establish a 401(k) for himself and his several employees, he has already maximized his contributions to his qualified plan and does not have any additional retirement assets. Additionally, Larry recognizes that he will be taxed on the distributions he receives from his 401(k) at retirement, which means that he will ultimately have less to spend for his retirement needs than the amount that appears on his plan statement balance and he would like to make up for this retirement shortfall.

STRATEGY:

Life Insurance for Supplemental Retirement Income

Larry purchases and owns a cash value life insurance policy on his own life, and names his wife as the beneficiary. In the event of his premature death, his wife will receive the policy's death benefit income tax-free[4] to help protect his family's financial security and all of the dreams they shared. Since Larry properly funds his cash value policy, the policy cash value grows tax-deferred and is available for Larry to access as the owner of the policy. In order to provide supplement retirement income, Larry is able to take tax-free[5] loans and withdrawals from the available cash value in the policy.

4 For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

5 For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death; (3) withdrawals taken during the first 15 policy years do not occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC Secs. 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.

LIFE INSURANCE FOR SUPPLEMENTAL RETIREMENT INCOME PROFILE:

- Individual with a need for death benefit protection for his or her family.
- At least 10 years away from retirement and has a need for supplemental retirement income.
- Your client is comfortable with the policy's death benefit proceeds being includable in his or her taxable estate at death.

1

Client purchases a personally owned cash value life insurance policy on his or her life.

2

Any growth in the policy's cash value is tax-deferred.

3

During his or her lifetime, the client may take tax-free[5] loans or withdrawals from the policy's available cash value to supplement his/her income.

4

At the client's death, his or her policy beneficiaries are paid the policy's death benefit income tax-free.[4]

Financial Tool	Annual Limits on Contributions	Tax-Deductible Contributions	Tax-Deferred Accumulation	Income Tax-Free Distributions/ Withdrawals	Penalty Tax for Early Withdrawal	Income Tax-Free Death Proceeds
Traditional IRA	Yes	Yes**	Yes	No	Yes	No
Roth IRA	Yes	No	Yes	Yes††	Yes††	Yes††
Qualified Plan	Yes	Yes	Yes	No	Yes	No
CD*	No	No	No	No	No	No
Mutual Fund†	No	No	No	No	No	No
Municipal Bond‡	No	No	Yes	Yes	No	No
Individual Owned Deferred Annuity	No	No	Yes	No	Yes	No
Life Insurance	**No§**	**No**	**Yes**	**Yes‡‡**	**No‡‡**	**Yes§§**

Income tax treatment includes the treatment of Capital Gains and Dividends. This chart excludes Estate Tax treatment. There are ways to structure your estate to help protect against this impact. Consult with your life insurance producer and independent tax advisor before purchasing any financial products.

* A Certificate of Deposit (CD) is FDIC insured.

† Mutual funds may be subject to income tax and/or capital gains tax. Consult your tax advisor for more information.

‡ Municipal bonds: Generally, interest paid on municipal bonds is tax-free, but not all municipal bonds are exempt from federal and/or state income tax. Some bonds may be subject to capital gains tax at sale. Consult your tax advisor for more information.

§ Life Insurance: There is not a specific limit on dollars allocated to purchase life insurance; however, there are maximum premium limits determined by a specified policy face amount. A policy will qualify as life insurance if it meets the requirements of IRC Sec. 7702, which includes limits on the amount of premium that may be paid into a specific face amount and still qualify as life insurance.

** Traditional IRA: If you are covered by a qualified retirement plan at work, traditional IRA contributions are fully deductible only if your adjusted gross income falls under the following amounts (for 2022): single up to $68,000; married filing jointly $109,000. Source: https://www.irs.gov/newsroom/irs-announces-changes-to-retirement-plans-for-2022.

†† Roth IRA: A distribution from a Roth IRA generally is income tax-free and penalty-free if (a) it meets all the requirements for a qualified distribution (which include a 5-year waiting period and one of several additional requirements, one being that the distribution is made to a beneficiary on or after the death of the individual), or (b) it is a nonqualified distribution to the extent of after-tax contributions (basis) see IRC Sec. 408A.

‡‡ Life Insurance: For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death (any outstanding policy debt at time of lapse or surrender that exceeds the tax basis will be subject to tax); (3) withdrawals taken during the first 15 policy years do not cause, occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. Any policy withdrawals, loans, and loan interest will reduce policy values and may reduce benefits.

§§ Life Insurance: For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e. the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

POTENTIAL ADVANTAGES:

- The life insurance policy's death benefit provides Larry's wife and family with financial protection should he die prematurely.
- The life insurance policy cash value grows tax-deferred.
- Larry does not have to comply with the funding requirements and non-discrimination rules for qualified plans.
- Larry may access the life insurance policy's cash value to supplement his retirement income.

CONSIDERATIONS:

- The life insurance policy's death benefit proceeds will be includable in Larry's taxable estate.[6]
- Cash value life insurance has various charges that are deducted from the cash value in order to provide the death benefit protection, so there should be a need for additional death benefit protection by the insured.

POTENTIAL ADD-ON STRATEGY:

Split-Funded Defined Benefit (SFDB) Plan

Because Larry is an owner of a pass-through entity (Pages Consulting is taxed as an S-Corporation), he could potentially qualify for a 20% deduction on the Qualified Business Income (QBI) of the business under Internal Revenue Code section 199A ("199A").[2] Since Pages Consulting provides consulting services, the business would be considered to be a "Specified Service Trade or Business" (SSTB) under 199A. As an SSTB, in order to qualify for the deduction, his total taxable income (including any income of his wife, as they file jointly) must be under a certain amount ($340.100 for 2022) to receive the full 20% deduction. Larry makes $500,000 per year and although his wife has no income, they only need $300,000 a year to live off. In order to lower his taxable income to qualify for the deduction, Larry can implement and contribute to a Split-Funded Defined Benefit Plan for the next several years.

A Split-Funded Defined Benefit (SFDB) plan is a type of a defined benefit plan. A defined benefit plan is a qualified plan designed to provide the participant with a stated benefit at retirement,[7] which in the case of older participants, generally will allow a business to make much larger contributions to the plan than it could make to a defined contribution plan (e.g., a 401(k)-profit-sharing plan). Split-Funded means that is funded with both securities and life insurance. Including an incidental amount of life insurance in the plan not only allows the participant to meet his or her life insurance needs using pre-tax dollars, but also increases the annual deductible contribution without reducing the retirement income benefit.[8]

Since contributions to the SFDB plan are deductible to the business, if Larry is able to contribute $200,000 per year to the SFDB plan[9], he would be able to reduce his taxable income to $300,000 in order to qualify for the deduction under 199A. In addition to the benefit of having an additional retirement vehicle, by qualifying for the 199A deduction, Larry also now has additional cash flow, which would have otherwise been paid in income taxes, that he can use to make the premium payments[10] on his personally-owned policy for supplemental retirement income purposes.

SFDB PLAN PROFILE:

- Business owner of a pass-through entity (S-Corporation, Partnership, LLC, Sole Proprietorship).
- Is significantly closer to retirement age than his/her employees.
- Has relatively few employees or already has a defined contribution plan in place for the employees, such as a 401(k) plan.

6 According to the Tax Cuts and Jobs Act of 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are all $10,000,000 per person (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%. In 2026, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are scheduled to revert to $5,000,000 per person (indexed for inflation for tax years after 2011).

7 In 2022, the maximum benefit that may be provided by a defined benefit plan is $245,000 per year.

8 It is important to emphasize that the amount of plan contribution that can be allocated to the life insurance premium and the amount of death benefit proceeds that can be paid out in the event of death are limited under the "incidental death benefit" rules for qualified plans. Additionally, the use of life insurance in a qualified plan must meet certain nondiscrimination rules. Participants are urged to discuss these limitations and rules with a qualified plan third-party administrator (TPA) before placing life insurance inside a qualified plan. Experienced qualified plan TPAs can assist participants in selecting an appropriate plan design, as well as offer help, together with the plan's legal and tax advisors, in navigating the myriad qualified plan rules and regulations to achieve specific objectives.

9 The amount that can be contributed to the qualified plan for each participant must be calculated by a qualified TPA.

10 Cash Value Life Insurance generally requires additional premium payments after the initial premium. If either no premiums are paid, or subsequent premiums are insufficient to continue coverage, it is possible that coverage will expire.

CASE STUDY: EXECUTIVE BENEFITS

SITUATION:

Suzanne owns a business that designs and creates product display stands in stores. Suzanne has a good number of employees that all have different roles and there is not a clear "rank-and-file" vs. select group of management grouping of employees. Suzanne has several of her key employees that always put in extra effort to make sure the clients are happy, one of whom is Jackson.

CHALLENGE:

Suzanne wants to reward Jackson for his hard work and the extra effort that she notices he puts in. Because he has such a good work ethic, she wants to make sure she does not lose him as an employee either. Even though Suzanne wants to reward Jackson, she isn't able to put a Non-Qualified Deferred Compensation Plan in place for him due to ERISA (Employee Retirement Income Security Act of 1974) requirements, and for the same reason, doesn't want to establish a qualified plan that she would have to offer to all employees.

STRATEGY:

Executive Bonus Arrangement

Suzanne establishes an Executive Bonus Arrangement for Jackson. Suzanne agrees to assist Jackson with the purchase of a cash value life insurance policy through a series of taxable bonuses. The bonuses are potentially tax-deductible to Suzanne's business, so she chooses to "gross-up" the bonuses to Jackson to help reimburse him for the income taxes generated as a result of the additional compensation. Jackson uses the bonuses to purchase a personally-owned life insurance policy and maintains complete ownership of the policy. As an additional benefit, Jackson will be able to access any available cash value in his policy. However, if Jackson were to leave the company while the policy is still in the premium paying stage, he would have to then come up with the funds for the premiums himself or risk the policy potentially lapsing. This aspect incentivizes Jackson to stay with the company and accomplishes the retention that Suzanne wanted.

CASE STUDY: EXECUTIVE BENEFITS *(continued)*

EXECUTIVE BONUS PROFILE:

- Owner and non-owner executives of C-Corporations.
- Non-owner executives of pass-through entities.
- Employers who want to recruit, reward and retain key employees.
- Employers who want to offer benefits in excess of those offered by the qualified retirement plans they offer or do not want to be limited by the same non-discrimination rules.

POTENTIAL ADVANTAGES:

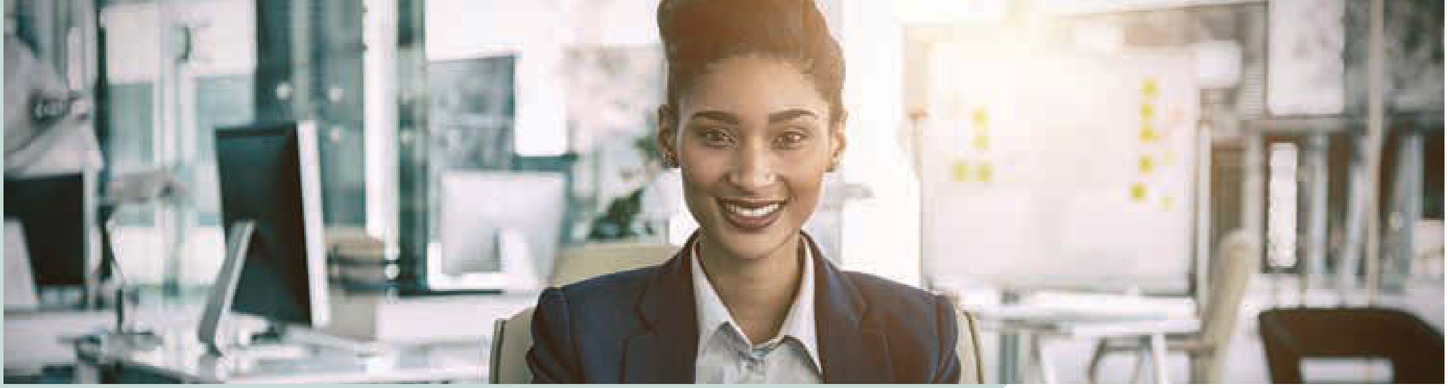
- Tax deductible bonuses[11] are used to provide the benefit.
- Little to no administration cost since a TPA is not required.
- There are no minimum participation requirements, such as with a qualified plan.
- Executive is able to access any available cash value for potential supplemental income.
- The policy is portable should the insured employee cease working for the employer.

CONSIDERATIONS:

- The executive must recognize the bonus payments as taxable income.
- The employer may not recapture the bonuses already paid to the executive should the executive decide to leave.
- If the executive separates from service, or the arrangement is terminated, the executive will have to personally pay any future premiums or the policy may lapse.

ALTERNATIVE EXECUTIVE BENEFITS OPTIONS:

- Restricted Executive Bonus Arrangement
- Split-Premium Bonus Arrangement
- NQDC Plan
- Split-Dollar (loan regime or economic benefit regime)



CASE STUDY: KEY PERSON PROTECTION

SITUATION:

Beth owns a successful technology start-up company, Alta, Inc., which has been growing rapidly since she started it ten years ago. The success of the company has been due largely to the cutting-edge programing and innovative algorithms created by Beth's lead engineer, Kevin, who has worked for Alta since Beth started the company. Kevin is extremely intelligent and gifted, but he was not always as skilled of an engineer as he is now – he has grown with the company and increased his knowledge and skillset over the years.

CHALLENGE:

Beth relies heavily upon Kevin's skills and abilities in creating and updating new technology solutions. Beth fears that if something were to unexpectedly happen to Kevin, or if he were to be hired away by another technology company, that loss would cause a disruption in production and would be financially devastating to Alta. To hire someone new to replace Kevin would require finding someone who is already at the experience level of Kevin, which in the competitive tech industry, would mean offering a significantly higher salary than what she is paying Kevin. Further, time and resources may need to be invested in additional training for a new employee to get them up to speed with Kevin's knowledge of the company's programming.

STRATEGY:

Business-Owned Key Person Policy

To protect Alta against the unexpected loss of Kevin, Alta provides Kevin with the proper notice and consent and takes out a life insurance policy on Kevin's life, of which Alta is the owner and beneficiary. Should something unexpectedly happen to Kevin and he were to die prematurely, Alta will receive the policy death benefit proceeds tax-free[12] to be able to use to hire and train an adequate replacement for Kevin. Should Kevin be poached by another tech company and leave, Alta, as the owner of the policy, can access any available cash value in the policy to take out potentially tax-free[13] loans or withdrawals to assist with the cost of securing the replacement for Kevin.

11 The deductibility of the bonus is subject to the reasonable compensation limits established by IRC Sec. 162(a).

12 For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

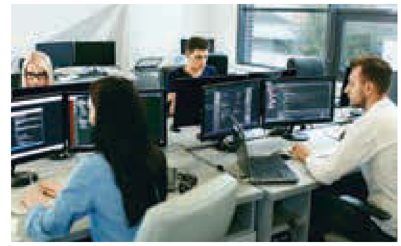
13 For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death; (3) withdrawals taken during the first 15 policy years do not occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC Secs. 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.

Key Person

1

Notice and Consent

Business



2

Premium

3

Death Benefit

Life Insurance Policy

1 **Notice and Consent:** The business provides written notice to the key executive that it intends to buy and be the beneficiary of life insurance on the key executive's life and may choose to continue the coverage beyond the executive's employment. The business must also notify the key executive as to the maximum amount of life insurance that could be placed on the key executive's life. The key executive then provides the business with written consent to purchase the life insurance.

2 **Premium:** The business buys life insurance on the key executive's life and retains all ownership rights. The business pays the life insurance policy premiums and is the beneficiary of the policy's death benefit.

3 **Death Benefit:** At the executive's death, the business will receive the life insurance death benefit income tax-free.[12]

POTENTIAL ADVANTAGES:

- Alta will be provided with financial protection against the premature death of Kevin.
- Alta will have the liquidity needed at the loss of Kevin to recruit and train a suitable replacement.
- If cash value life insurance is utilized:
  - The cash value of the policy will grow on a tax-deferred basis.
  - Alta may book the cash value of the policy as an asset on its balance sheet.
  - Alta may access any available cash value for emergencies or other financial needs.
- A cash value key person life insurance policy could be utilized as the informal funding vehicle for a Non-Qualified Deferred Compensation plan.

CONSIDERATIONS:

- As an asset of the business, the policy may be subject to any creditors of Alta.
- Since Alta is both the owner and the beneficiary of the policy, Alta may not deduct the cost of the life insurance policy premiums[14].

14 IRC Sec. 264(a)(1)

CASE STUDY: BUSINESS SUCCESSION

SITUATION:

Benjamin is 60 and owns Parts-4-U, an automotive manufacturing company, which he started 30 years ago and built from the ground up. Benjamin is married with three daughters, but none of them are active in the business or have any desire to take over the business when Benjamin retires or passes away. Although he has many employees that work in the manufacturing facility, only a select few of his employees are key executives or hold an officer position. One of those few employees is Benjamin's Vice President, Ethan. Ethan is Benjamin's most trusted executive and has been with the company for many years. He has worked his way up to the prominent position he now holds within the company and knows the ins and outs of the company just as well as Benjamin.

CHALLENGE:

While Benjamin loves his company and what he does, as he gets older, he does not have the energy that he used to and may decide to retire in ten years. After putting so many years in to build Parts-4-U into the successful manufacturing company it is today, Benjamin wants to ensure that the company continues successfully beyond his working years. Benjamin has always invested back into the company and has no outside retirement assets. In order to retire comfortably, Benjamin needs to sell the business, but does not feel comfortable handing his business off to an outside buyer that he does not know and trust will run things the way he has. Since none of his daughters have any desire to take over the business, Benjamin must find another buyer that he knows will be able to purchase the company from him when he wants to retire.

STRATEGY:

One-Way Buy-Sell

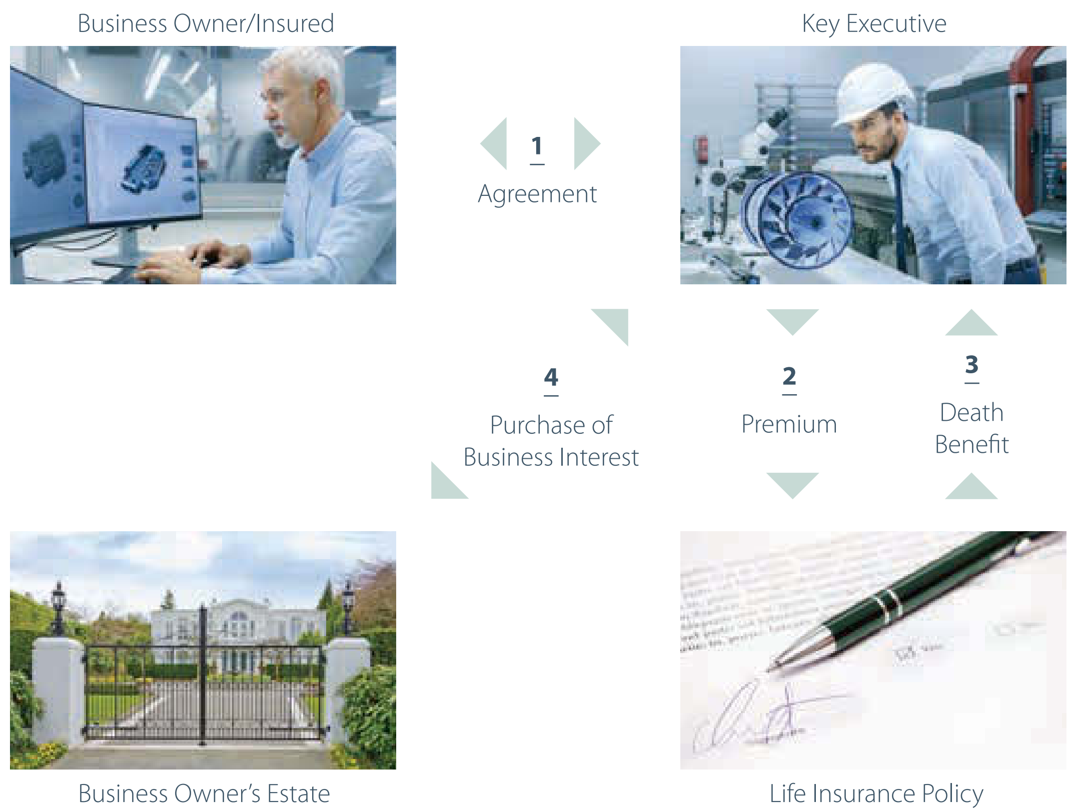
Benjamin knows that Parts-4-U would continue to thrive with Ethan in charge and decides that he would like for Ethan to take over the business from him. Ethan agrees, and they enter into a One-Way Buy-Sell agreement, the terms of which obligate Ethan to purchase Parts-4-U from Benjamin upon Benjamin's retirement or death. To fund the buy-sell, Ethan purchases a cash value life insurance policy on Benjamin's life, of which Ethan is the owner and beneficiary. Should Benjamin die prematurely, Ethan will receive the policy death benefit proceeds income tax-free[15] to use to purchase the business from Benjamin's estate. If Benjamin survives until his retirement date, Ethan can access the available cash value within the policy for tax-free[16] loans or withdrawals to help purchase Parts-4-U from Benjamin.

15 For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

16 For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death; (3) withdrawals taken during the first 15 policy years do not occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC Secs. 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.

ONE-WAY BUY-SELL PROFILE:

- Sole business owner.
- Key executive or family member that is active in the business, to whom the business owner would like to sell his or her interest in the business.



1 **Agreement:** Working with their tax, legal, and financial advisors, the business owner and the key executive enter into a one-way buy-sell agreement. The agreement will require the key executive to purchase the business owner's interest in the business for an agreed upon price upon the business owner's death or retirement.

2 **Premium:** To fund his or her purchase obligation, the key executive, working with a life insurance producer, will purchase a life insurance policy on the life of the business owner. The key executive will pay the policy premiums and will be the policy beneficiary. To assist with the premium payments, the business may provide the key executive with a taxable bonus or a series of taxable bonuses.

3 **Death Benefit:** At the business owner's death, the key executive will receive the life insurance death benefit proceeds income tax-free.[15] Or, if the owner retires, the key executive may access the available cash value via tax-free loans and withdrawals.

4 **Purchase of Business Interest:** The key executive may apply the death benefit proceeds towards the purchase of the business owner's interest in the business from his or her estate.

POTENTIAL ADVANTAGES:

- Benjamin will have a willing buyer for the business at his death or retirement.
- Benjamin will know that Ethan will be the person managing the company after Benjamin's death or retirement.
- The proceeds from the sale may provide a source of income for Benjamin's wife after his death.
- Ethan will receive basis in the business equal to the purchase price.

CONSIDERATIONS:

- Benjamin must rely on Ethan to actually purchase the business upon Benjamin's death or retirement.
- Ethan must pay the premiums for the life insurance policy, unless an Executive Bonus or SERP Buy-Out arrangement is implemented as well.
- The life insurance policy's cash value would be includable in Ethan's estate if he were to predecease Benjamin.
- Benjamin's family would no longer own the portion of the business sold to Ethan.

POTENTIAL ADD-ON STRATEGIES:

EXECUTIVE BONUS ARRANGEMENT

To assist Ethan with making the premium payments for the policy that Ethan owns on Benjamin's life for the purpose of the buy-sell, the company could establish an Executive Bonus arrangement to provide a series of taxable bonuses to Ethan, which are deductible to the business within reasonable compensation limits.

SERP FOR A "SERP BUY-OUT"

If Benjamin has a set date that he plans to retire, an alternative option to assist Ethan with the buy-out, is to establish a Supplemental Executive Retirement Plan (SERP), which is a type of Non-Qualified Deferred Compensation plan that consists solely of employer contributions. These types of plans may only be offered to "top-hat" employees, such as Ethan. Typically, a SERP pays a benefit at the executive's retirement, but here the SERP agreement can provide for a specified time distribution trigger and a 10 year cliff-vesting schedule, at which time a lump sum benefit can be paid to Ethan when Benjamin retires. The SERP can serve as both an executive retention strategy and as a sinking fund to help ensure that the funds for the buy-out will be there when Benjamin retires.

For a SERP, the employer may informally fund the promised benefit with any asset it deems appropriate, such as life insurance, which is usually in the form of a key person policy. Accordingly, the business can purchase a cash value policy on Ethan's life as informal funding for the SERP. To provide interim funding for the buy-sell prior to Benjamin's set retirement date, should Benjamin die prematurely, Ethan could also purchase a term policy on Benjamin's life to cover this period.

ALTERNATIVE BUSINESS SUCCESSION OPTIONS:

CROSS-PURCHASE BUY-SELL

- 2 or 3 business owners.
- Business owners own policies on each other's lives to be able to purchase the exiting business owner's interest.

ENTITY REDEMPTION BUY-SELL

- 3+ business owners.
- The business owns policies on the business owners' lives to be able to purchase/redeem the exiting business owner's interest.

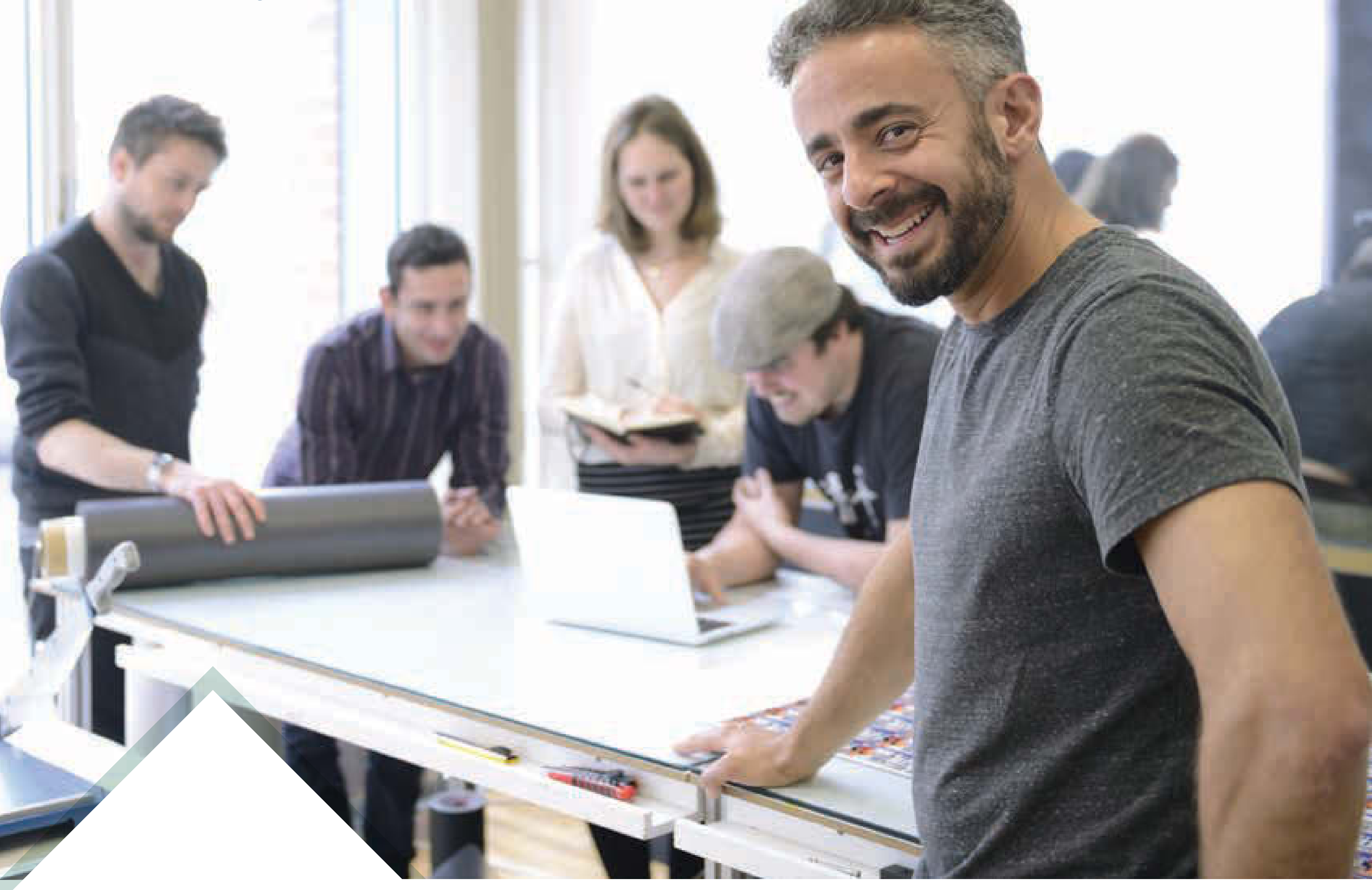
INSURED CONTROLLED CROSS-PURCHASE BUY-SELL

- Owners are partners in a partnership or a limited liability company (LLC) that is taxed as a partnership. A partnership is a required in order for the arrangement to qualify for an exception to the "transfer-for-value" rule, but that partnership does not need to be the business that is subject to the buy-sell.
- 2 or more business owners.
- Each business owner owns a policy on his or her own life and has an endorsement split-dollar arrangement in place to endorse the death benefit out to the other business owner(s).
    - Each business owner must pay the Reportable Economic Benefit (REB) cost annually to the business owner(s) from whom they are receiving the endorsement.

Conclusion

Small businesses account for an overwhelming majority of the businesses in the United States, creating a large market of business owners. Business owners often have multiple planning needs across various planning areas. It is important to ask the right questions, which may include industry-specific considerations, to identify your client's planning needs in order to uncover potential planning opportunities that would have otherwise been left on the table and not addressed for your client. Pacific Life can help you help your client by assisting you to identify these opportunities.

For more information on the planning opportunities in the Playbook, visit Lifeline.com for additional materials or contact Pacific Life's Advanced Designs Unit at 800.800.7681 ext. 3690.



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