Business Liquidation Insurance Considerations

Have you considered the impact your death or disability could have on the value of your business, and on the stream of income upon which you and your family depend?

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When Is Business Liquidation an Appropriate Decision?

In some situations, the liquidation of a business interest at an owner's death or disability may not be just an appropriate decision. It may, in fact, be the only possible outcome under either of these circumstances:

- The success of the business is completely dependent on the personal skill and experience of the owner.
- There is no successor management in the form of a capable family member, a co-owner, a key employee interested in purchasing the business or an outside buyer.

In these circumstances, the question then becomes:

Will the liquidation take place on a forced basis, or will it be planned in advance to allow for the most advantageous disposition possible?

Potential Results of a Forced Liquidation

If liquidation is forced on a disabled business owner or on the executor of a deceased business owner, it can quickly become public knowledge that there is pressure to dispose of the business, and these results can be anticipated:

- Sale of business assets at greatly reduced prices.
- Elimination of the disabled business owner's or surviving family's primary source of income.
- Sacrifice of any goodwill value that might have facilitated sale of the business as a going concern.
- Difficulty in collecting accounts receivable.
- Immediate demand by creditors for settlement of their claims.
- Possible liquidation of other estate assets to pay business debts.

The liquidation value of a business is unpredictable and may be substantially less than the value of the business as a going concern.

The Alternative: A Planned Liquidation

When liquidation of the business at an owner's death or disability is the only viable alternative, the primary objective should be to plan in advance for an orderly liquidation that results in the greatest possible value for the disabled owner or surviving family.

There are two needs that must be met for a business liquidation to take place on a planned, orderly basis:

Authority and **Time**

Let's see how these two requirements interact with one another.

Need for the Proper Authority

While alive, a business owner generally has the authority to sell the business or its assets...the power to decide what will be sold, to whom, for how much and when the sale will take place.

It is critical that the business owner's executor have these same powers to dispose of the business after the owner's death. This requires a properly-drafted will that gives the executor the authority and flexibility to dispose of the business in the most advantageous manner available. Recommended will provisions include:

Method and Terms of Sale

The executor should be given broad powers to decide how the business will be sold and to determine the purchase price and mode of payment.

Timing of Sale

The executor should be given the authority and means to continue operating the business until it can be disposed of advantageously.

Personal Liability

The will should free the executor from personal liability for the reasonable actions he or she takes in disposing of the business.

However, a disabled business owner or an executor with broad powers to dispose of a business still needs time to plan and implement the liquidation in an advantageous manner.

Need for Time

At Death

While a properly-drafted will can give an executor the authority and flexibility to manage a planned liquidation, there must be sufficient liquidity in the deceased owner's estate to provide the time needed for a planned liquidation.

At a business owner's death, funds may be needed:

- to pay estate taxes and other estate settlement costs; and
- to continue an income to the surviving family.

Unless there is sufficient liquidity in the estate to satisfy these needs, the executor may be forced to dispose of the business at the earliest opportunity.

At Disability

In order to extract as much of its value as possible, a disabled business owner needs time to liquidate a business interest in an orderly manner.

To achieve this objective, the business owner must have a source of income, or he or she may be forced to liquidate the business.

Business Liquidation Insurance Considerations: In the Event of Death

When business liquidation is the only course of action at an owner's death, **life insurance** can provide the funds that make the difference between a planned liquidation and a financially-disastrous forced liquidation.

Consider the uses to which **life insurance** can be put in the planned liquidation of a business:

Estate Settlement

Life insurance proceeds can be used to pay estate taxes and other estate settlement costs, allowing the liquidation to proceed on an orderly basis.

Family Income

Using life insurance proceeds to provide the surviving family with a continuing income can avoid a forced liquidation of business assets for this purpose.

Working Capital

If the executor needs additional cash to temporarily operate the business, life insurance can serve as the source of that cash.

Offset Shrinkage

Even a planned liquidation will usually result in some shrinkage in value, as compared to what the business was worth as a going concern. Life insurance can be used to replace the value lost in the liquidation.

Only **life insurance** can guarantee that the cash needed to avoid a forced liquidation will be available exactly when needed -- at the business owner's death (guarantee is based on the continued claims-paying ability of the insurer).

Business Liquidation Insurance Considerations: In the Event of Disability

When disability strikes, most business owners want time in order to assess the likely duration and impact of the disability, before making business liquidation decisions. Without advance planning, however, even a short-term disability can result in a forced business liquidation.

A Short-Term Disability...

The Situation	Potential Insurance Solutions
If a business owner wants to keep the business open during a shorter-term disability and avoid a forced liquidation, funds are needed: ■ to pay business operating expenses during the disability; and ■ to continue an income to the owner.	■ **Business overhead expense insurance** can be used to reimburse the business owner for business expenses during periods of shorter-term disability. ■ **Disability income insurance** can be used to replace business income lost while the owner is sick or hurt and unable to work.

A Longer-Term Disability...

The Situation	Potential Insurance Solution
With a longer-term disability, the owner needs time to liquidate the business in an orderly manner. Without sufficient income, however, the business owner may be forced to liquidate both business and personal assets in a disadvantageous manner.	**Disability income insurance** can be used to replace the income previously generated by the business, giving the owner the time necessary to execute an orderly business liquidation.

Business Liquidation Insurance Considerations Action Checklist

To Implement a Life Insurance Plan…

- ☐ Determine the life insurance funding necessary to avoid a forced liquidation of the business.
- ☐ Select the appropriate life insurance funding vehicle.
- ☐ Establish the owner's insurability.
- ☐ Determine the best premium payment arrangement.

To Implement a Disability Insurance Plan…

- ☐ Determine the type and amount of disability insurance necessary to avoid a forced liquidation of the business.
- ☐ Select the appropriate disability insurance policy(ices).
- ☐ Establish the owner's insurability.
- ☐ Determine the best premium payment arrangement.

Annual Review…

- ☐ An annual review can help ensure that the plan and its funding remain adequate in order to avoid a forced liquidation.

Important Information

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