Allianz Life Insurance Company of North America

Small business life insurance overview

Business planning with life insurance

M-5115 (R-1/2024)

Small business is a significant opportunity for your business.

Small-business owners – especially affluent owners and those with a family – represent a lucrative market with favorable demographics.

- They have a need for life insurance.
- They need to protect their business.
- They are at the prime buying age for life insurance products.
- They possess significant assets to purchase these products.

The death benefit protection and potential cash value accumulation of fixed index universal life insurance can be used by your clients to help ensure the long-term viability of their business. The following page presents an overview of several of these business strategies.

Then, to help you identify the most appropriate solution for your client, we explain the most common business entities and the advantages and disadvantages of each.

Remember that any strategy that includes life insurance is contingent on the health underwriting of the insured and financial underwriting. In addition, these strategies require legal agreements drafted by an attorney.

	Executive bonus (162 bonus) plan	Restricted executive bonus arrangement plan
Highlights	Employer pays premium to provide life insurance coverage to key employees and owners	Employer pays premium to provide life insurance coverage for key employees. The employee cannot access the available cash value without the employer's consent; generally not used with the business owner(s).
Purposes	Provides tax-free death benefit protection and tax-deferred cash value accumulation potential, and may help retain valuable employees	Provides tax-free death benefit protection and tax-deferred cash value accumulation potential, and may help retain valuable employees
Appropriate business entity	• Sole proprietorship • Partnership • C corporation • S corporation • Limited liability company	• Sole proprietorship • Partnership • C corporation • S corporation • Limited liability company
Owner/ employer benefits	• Helps retain key employees • Freedom to favor select employees • Fringe benefit to key contributors • Tax-deductible premium to business • Easy to implement • No IRS approval needed	• Helps retain key employees • Freedom to favor select employees • Fringe benefit to key contributors • Tax-deductible premium to business • No IRS approval needed
Employee benefits	• Very low- or no-cost life insurance protection • Tax-deferred cash value accumulation potential • Completely portable	• Very low- or no-cost life insurance protection • Tax-deferred cash value accumulation potential
Additional considerations	• Premium bonus may place employee in higher individual income tax bracket • Failure to follow the terms of a redemption agreement may cause the value of the death benefit to be included in the value of the business interests being redeemed for estate tax purposes	• Premium bonus may place employee in higher individual income tax bracket • Requires signed Restricted Policy Agreement Allianz form NB6066
Premium payor	• Business pays premium for convenience **OR** business pays cash to employee who pays premium • Employee reports premium as bonus • Double bonus can cover employee's tax	• Business pays premium for convenience **OR** business pays cash to employee who pays premium • Employee reports premium as bonus • Double bonus can cover employee's tax
Owner and beneficiary	Employee owns policy and designates their beneficiary	• Employee owns policy and designates the beneficiary • Employer and employee sign Allianz form NB6066
Income tax	• Premium tax-deductible by business if overall compensation is reasonable • Premium bonus included in employee's taxable earnings • Income-tax-free death benefit to employee beneficiaries	• Premium tax-deductible by business if overall compensation is reasonable • Premium bonus included in employee's taxable income • Income-tax-free death benefit to employee beneficiaries
Estate tax	Insurance included in employee's taxable estate	Insurance included in employee's taxable estate

	Nonqualified deferred compensation (NQDC) plan	Key person life insurance	Buy-sell cross-purchase agreement
Highlights	Life insurance with cash value accumulation potential can be used to help secure future benefits	Protects business against financial loss in case of a key person's death	Each owner purchases life insurance on the other owner(s) to buy and sell their respective business interests
Purposes	Helps retain valuable employees through obligations to pay future benefits to key employees, which can be informally funded by life insurance	Tax-free money to reimburse business so it can recruit, hire, and train a replacement	Insurance proceeds used to buy business interest from deceased owner's estate
Appropriate business entity	• C corporation • S corporation • Limited liability company	• Sole proprietorship • Partnership • C corporation • S corporation • Limited liability company	• Partnership • C corporation • S corporation • Limited liability company
Owner/ employer benefits	• Helps retain key employees • Must favor select employees • Employer may recover all costs • No IRS process approval needed	• Helps offset financial loss • Cash value accumulation potential may offset cost of premium	• Helps prevent forced liquidation of business • Fair market value for business guaranteed • Keeps ownership of business from heirs or outsiders • Helps ensure continuation of business
Employee benefits	• Supplement retirement income through benefits paid by plan • Benefits can be designed specifically for each participant • No reportable income until benefits received • May provide survivorship benefits	If employee retires, business can use policy to fund nonqualified plan at retirement for employees, or fund a death benefit plan for employee's family	• Provides a ready market for business upon death • Discounted money used to fund ownership obligations • Buyers of the business interest receive new basis
Additional considerations	• Employer deduction is delayed until benefits are actually paid • Survivorship benefits are taxable income to employee's family • Funding vehicle used must be subject to company creditors • Employees must not have rights to specific assets because it's an unfunded promise to pay	Premium paid with after-tax employer money	• Generally, a cross-purchase agreement works best with three or fewer partners. If there are more than three partners, they could explore an entity purchase agreement. • The number of policies increases with each additional owner • Wide age differences among owners will create disparity in premium
Premium payor	Business	Business	Each partner or shareholder pays for policy of life of the other partner(s) or shareholders(s)
Owner and beneficiary	Business is owner and beneficiary	Business is owner and beneficiary	Each partner or shareholder is owner and beneficiary of policy on the life of the other owner partner(s) or shareholder(s)
Income tax	• Employer premium not deductible • Employer contributions not taxable to employee • Loans and withdrawals are taxed to the employer • Death benefits taxable to employee and/or beneficiary when paid out • Benefit payments deductible by corporation • Before policy is issued, insured must sign consent and be given written notice of the policy to obtain an income-tax-free death benefit to the business • Taxable to employee once benefits are received	• Premium not deductible by employer • Premium not taxable to employee • Income-tax-free death benefit to the business • Distributions to employee or family may be subject to income tax • Before policy is issued, insured must sign consent and be given written notice of the policy to obtain an income-tax-free death benefit to the business	• Premium not deductible • Upon death of owner, appreciated ownership interests in business receive a stepped-up basis, with no income tax to decedent's family • Surviving business owners get basis for the purchase of deceased owner's interest • Death benefit received income-tax-free by other partner(s) or shareholder(s)
Estate tax	Present value of benefit included in employee's taxable estate	May increase value of business interest included in estate of key owner	• Purchase price paid for business interest included in deceased partner's or shareholder's estate, if agreement is at arm's length • When owners are family members, the IRS may find the buy-sell value unacceptable for estate valuation

	Buy-sell entity purchase agreement	Partnership buy-sell agreement	Split-dollar
Highlights	Business purchases life insurance on the owners to redeem deceased owners' business interests	Existing C or S corporation with 3 or more owners establishes a new partnership (or LLC taxed as a partnership) to purchase cash value life insurance for business continuation purposes	A life insurance benefit a business provides to a key employee. The insured on the policy is the key employee, and the business pays all or some of the policy premiums. At the employee's death, the life insurance proceeds are split according to a previously executed agreement by the business and the key employee.
Purposes	Insurance proceeds used to buy business interest from deceased owner's estate	Insurance death benefits distributed from partnership to surviving partners are used to purchase C or S corporate stock and the partnership interest of deceased owner. Insurance policy is transferred to an owner upon retirement for personal use of policy and cash values.	This is an arrangement between two parties, the employer and a key employee, in which they share and split a life insurance policy according to a previously executed agreement by the business and employee. The policy can be used as an incentive or as a form of deferred compensation.
Appropriate business entity	• Partnership • C corporation • S corporation • Limited liability company	• C corporation • S corporation	• Partnership • C corporation • S corporation • Limited liability company
Owner/ employer benefits	• Helps prevent forced liquidation of business • Fair market value for business guaranteed • Keeps ownership of business from heirs or outsiders • Only purchase one policy per owner • Business pre-funds its obligations with discounted money	• Helps prevent forced liquidation of business • Fair market value for business guaranteed • Keeps ownership of business from heirs or outsiders • Only purchase one policy per owner	Retain key employees
Employee benefits	• Provides a ready market for business upon death • Value of stock (not the basis) owned by surviving owner(s) increases if corporation retires stock	• Buyers of business interest upon insured's death receive a stepped-up basis • Distribution of life insurance policy from partnership to a retiring partner is not a taxable event • Tax-deferred cash value accumulation for retirement when policy is distributed	Provide survivor income to beneficiaries, help address estate-tax concerns
Additional considerations	• There may be no increase in cost basis for surviving owner(s) • Failure to follow the terms of a redemption agreement may cause the value of the death benefit to be included in the value of the business interests being redeemed for estate tax purposes	• For existing C or S corporation with more than 3 owners, a new partnership (or new LLC taxed as a partnership) is used to own the life insurance policies • For existing partnership or LLC taxed as a partnership, the existing entity is used to own the life insurance. See buy-sell entity purchase column.	There are two options for split-dollar arrangements: the endorsement method and collateral assignment method
Premium payor	Business	Existing C or S corporation pays the premium on behalf of the partnership. Premium is considered a taxable bonus to the owners and a contribution by the owners to the partnership	Business
Owner and beneficiary	Business is owner and beneficiary	Partnership or LLC taxed as a partnership is owner and beneficiary of the life insurance policies	Depends on type of split-dollar agreement; owner could be the business or key employee. • Endorsement method: employer owned • Collateral assignment method: employee owned
Income tax	• Premium not deductible • Upon death of owner, appreciated business assets receive a stepped-up basis, with no income tax to decedent's family • Before policy is issued, insured must sign consent and be given written notice of the policy to obtain an income-tax-free death benefit to the business • Death benefit received income-tax-free to the business	• Payment of premium by existing C or S corporation is taxable income to the insured owner • Insured owner makes a contribution to the partnership or LLC taxed as a partnership equal to policy premium • Before policy is issued to obtain an income-tax-free death benefit, the new partnership or LLC taxed as a partnership must give insured written notice and obtain written consent from insured • If insured owner lives until retirement, his/her life insurance policy is transferred from the partnership or LLC taxed as a partnership to the insured, income-tax-free	The tax results depend on which method of split-dollar is used – the endorsement method or the collateral assignment method. See M-5776 for additional information.
Estate tax	• Purchase price paid for business interest included in deceased partner's or shareholder's estate, if agreement is at arm's length • When owners are family members, the IRS may find the buy-sell value unacceptable for estate valuation	• Purchase price paid for business interests included in deceased shareholder/partner's estate if agreement is at arm's length • When owners are family members, the IRS may find the buy-sell value unacceptable for estate valuation	The tax results depend on which method of split-dollar is used. Use collateral assignment method with Irrevocable Trust as the owner if estate tax concerns exist. See M-5776 for additional information.

	Sole proprietorship	Partnership	S corporation	C corporation	Limited liability company (LLC)
Summary and characteristics	A sole proprietorship (SP) is unique in that it is not treated as existing independently of its owner. Rather, the sole proprietorship is considered merely an extension of the individual owner. The business owner creates the sole proprietorship, gives the entity its name, and reports its profits and losses on his or her personal tax return.	A small general partnership is a business entity that consists of at least two partners. (There is no maximum limit on the number of partners.) A partnership is a pass-through business entity, so it is not taxed separately. Rather, the partners report their share of partnership income on their personal tax returns.	An "S corporation" is an incorporated business that has formally elected to be taxed as a pass-through entity. Without an S corporation election, the business will be taxed as a C corporation. Though the business may consist of many owners, it is considered a single entity, separate from the owners. Like a C corporation, an S corporation may raise its own money by selling shares of stock to shareholders. Unlike a C corporation, shareholders must meet certain eligibility criteria. The major difference between an S corporation and a C corporation is the tax treatment.	A "C corporation" is an incorporated business entity. Though the corporation may have many owners, it is nonetheless a single entity in the eyes of the law.	A limited liability company (LLC) is a hybrid of a partnership and a corporation. An LLC can be treated like a corporation for liability purposes and can be taxed as a partnership (or even a sole proprietorship). When taxed as a partnership, income, losses, and other tax attributes pass through to the owners either pro rata or as allocated in the operating agreement (also referred to as a limited liability company agreement or a member control agreement, which prescribes, among other things, how the LLC is to operate and the relationship between members). Such an allocation of tax attributes is referred to as each member's distributive share. The following discussion assumes that the LLC is taxed as a partnership.
Advantages	An SP can be freely sold. Upon the sale of the business, the former owner can keep all of the profits and deduct all losses. Profits are taxed only once. Management is centralized. SPs are relatively simple and inexpensive to create and maintain.	A small general partnership may be relatively simple and inexpensive to create and operate. There is no upper limit on the number and type of partners. Partnerships can be flexible in sharing profits and control. Profits are taxed only once. Partners can deduct losses and have them "specially allocable." A partner's "basis" is generally increased by partnership liabilities. Partners can contribute appreciated property tax-free.	Any liability is limited to the corporation. Pass-through taxation is similar to that of a partnership. S corporations have centralized management, and the life of the entity can continue indefinitely.	C corporations are virtually unlimited in the number and type of shareholders. Certain noncompensation fringe benefits are generally tax-free to shareholder-employees. Owners are generally not personally liable for the acts of a C corporation. Management is centralized. Interests are freely transferable. The entity is unrestricted in sharing ownership, profits, and control, and the life of the entity continues indefinitely.	When taxed as a partnership, income, losses, and other tax attributes pass through to the owners either pro rata or as allocated in the operating agreement. This can simplify some accounting and tax-reporting functions. Members can typically "bind" the LLC to protect themselves against liability, and also typically have a right to withdraw from an LLC.
Disadvantages	The sole proprietor is personally liable for the obligations of the SP. The life span of the SP is limited to the life of the sole proprietor.	Partners are personally liable. Each partner can typically "bind" the partnership. Partners typically cannot sell their partnership interest but they may have the right to withdraw from the partnership. A partnership does not possess continuity of life. Fringe benefits are taxable to the partner.	Limited to one class of stock. Other organizational and ownership limitations are necessary to maintain tax treatment as an S corporation.	Profits are taxed twice: once to the corporation and again to the shareholders. A C corporation may be relatively difficult and expensive to form and maintain. Entity is heavily regulated. Shareholders cannot deduct losses. Shareholders can be taxed on contribution of appreciated property. Liquidation of the corporation is a taxable event.	The life of an LLC may be limited, depending on the state in which it was formed and the terms set forth in the operating agreement. An LLC may be treated differently from state to state. Fringe benefits are taxable to member-employee.
Factors influencing choice of business structure	An SP is likely the most simple and inexpensive entity to form and maintain, and the person who establishes it will be the sole owner.	A small general partnership may be relatively simple and inexpensive to form and maintain, but it must have two or more owners (partners).	Must be a U.S. corporation, and all shareholders must consent to S corporation election. Corporation cannot be owned by more than 100 eligible shareholders.	A C corporation may be one of the most difficult and expensive entities to form and maintain. There are no prerequisites for forming a C corporation.	There are no prerequisites. An LLC may be relatively simple and inexpensive to form and maintain.
Additional considerations	Requirements for business permits may vary by state and/or municipality. The sole proprietor may be required to register the name of the proprietorship with their state or local government.	Though states vary in their treatment of general partnerships, most states follow some form of the Uniform Partnership Act.	State law governs corporate formation, and the Internal Revenue Code governs S corporation status and treatment. Costs of forming an S corporation vary by state.	Though the C corporation is a creature of state law, all states follow some form of the Revised Model Business Corporation Act.	Because they are relatively new, LLCs may not be treated as uniformly as a partnership or corporation.
Taxation	If the company is paying the premium and the policy is owned by the company, the premium is not tax-deductible (Internal Revenue Code (IRC) Section 264). If the company is paying the premium and the policy is owned by the employee, and the company is not directly or indirectly a beneficiary, the premium is tax deductible as compensation to the employer and taxable income to the employee (IRC 162).				

There are over 32.5 million small businesses in the U.S., which accounts for 99.9% of all U.S. businesses.[1]

[1] Small Business Profile, U.S. Small Business Administration, 2021.

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Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy.

If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change and your clients should consult a tax professional.

Guarantees are backed by the financial strength and claims-paying ability of Allianz Life Insurance Company of North America (Allianz).

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