



Is There a Substantial Unfunded Liability Lurking in Your Business Organization Documents?

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When you executed your articles of incorporation, LLC documents, or your partnership agreement, you started your company on the road to success. The business has done well and you have many front- burner activities vying for your time and attention. Most likely, you've not given much attention to what your documents say since the day they were executed. So, when the unthinkable happens and your business partner meets an untimely death, aside from the staggering realization that your business life has changed substantially, you will now be forced into becoming intimately familiar with what those documents require in order to ensure the future financial viability of the business.

Assuming the attorney that originally drafted the documents did a thorough job, there will be a section that will lay out the required actions and financial responsibilities of the remaining principals. This is commonly referred to as a buy-sell arrangement or a corporate stock redemption plan and will stipulate what happens in the event of the death or disability of a principal of a firm. Under the terms of the agreement, the remaining partners or shareholders will typically have agreed to purchase the business interest from the decedent's heirs for a stipulated price or a price derived from a previously agreed upon valuation formula.

After reviewing the documents, the next task is to write a check to the heirs. Where is the money going to come from? Will it come from retained earnings paid out over time on an installment basis? Will the company have to borrow the funds or mortgage assets to come up with the money? Will these methods have an adverse effect on the economic viability of the business? In order to cause the least drain on the business, the majority of buy-sell or stock redemption plans are funded with life insurance. Life insurance is considered the method of choice because implementation is straight forward, cost effective, and will deliver the appropriate amount of capital at the exact time it is required. It is, of course, important to make certain that the policy death benefits are kept consistent with the current valuation of the business so that the liability is not underfunded.

The incapacity of a principal is also addressed in a comprehensive buy-sell and disability buy-sell policies are available specifically designed to address this need. Because it takes three years of an entity's earnings history be available before an insurance carrier will issue disability buy out policies, many times this coverage simply never gets implemented even though the life policies have been put in place.

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