# Reducing risk to you and your family as a business owner.

Unforeseen events, such as illness, disability or death, can have a devastating effect on a business owner and their family. Insurance is an important part of a comprehensive wealth management plan, and helps to provide financial protection for individuals, their families and their businesses against the unexpected.

It is also a risk-management tool that provides a business owner or incorporated professional multiple benefits, including the potential for significant tax savings.

There are several insurance strategies that may be integrated into your wealth plan to supplement retirement savings, maximize the value of your estate and help protect you, your family and your business.

## Supplement your retirement using the corporate owned life insurance (COLI) retirement strategy

As a business owner or incorporated professional, a large portion of your net worth is likely tied up in your company. Even if you have maximized the tax-sheltering opportunities provided by your qualified retirement plans selected for your business, you may still want to consider additional options to help fund your retirement by accessing the funds accumulated in your company. Implementing the COLI retirement strategy with a life insurance policy can help you accomplish this by providing several key benefits:

- Life insurance protection
- Management of investment risk
- Tax-deferred growth of funds
- Potential tax-free access to those funds in the future
- Potential tax-free benefit for your estate

To implement the COLI retirement strategy, your company purchases a life insurance policy on your life. Premiums are structured to build cash value within the policy, so that investment earnings are tax-deferred until they are withdrawn. The premium payments will not be considered a taxable shareholder benefit if your company is both the owner and beneficiary of the life insurance policy.

When you retire, the life insurance policy is leveraged to access its cash value. Leveraging involves having your company arrange a loan or line of credit using the cash value of the policy as collateral. The leveraged funds are used to make a non-taxable distribution, taxable dividend, or bonus payments to you—depending on your entity structure.

Generally, a significant amount of the cash value within the policy can be borrowed. The company will be charged interest on the loan, but often this can be covered by an additional loan. The total borrowing must remain within lending limits based on the accumulated cash value within the policy to prevent your policy from terminating.

For this insurance strategy to provide the most benefit, you should put it in place well before you retire in order to accumulate sufficient cash value in the policy to generate the income you'll require.

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## Tax-efficient succession planning using the corporate asset transfer strategy

Often, business owners let assets accumulate inside their company to take advantage of lower corporate tax rates, or use in future expansion or capital needs. This often means overexposure to fixed income investments. The corporate asset transfer strategy helps to diversify your company's portfolio without sacrificing liquidity, while simultaneously maximizing the value of your estate that is passed on to your beneficiaries. This strategy can also provide a flexible tax-sheltered investment vehicle for any cash flow surplus in your business.

Your company purchases a life insurance policy on your life, and transfers a portion of its fixed income investments to the insurance policy. The policy's tax-sheltering characteristics prevent the substantial erosion of the value of these investments each year. Eventually, when the death benefit is paid, it may be received tax free by the business. The amount that exceeds the adjusted cost base of the policy could be passed on to your beneficiaries tax free.

## Protect yourself, your family and your business

Retirement, illness, disability or death of key personnel can have a major effect on the continuity of your business. There are several insurance strategies that can help to manage such life changes for you, your partners and key employees.

Key person insurance is an effective way to help protect against the loss of an individual critical to the success of the business, whether they leave by choice or due to death, illness or disability. The policy should cover the estimated financial loss to the business as a result of the loss of the key person.

Buy-sell agreements (often times the provisions of which are found in your operating agreement) between business owners offer a degree of protection. In the event of your business partner's death or disability, life insurance is a cost-effective way to fund a buy-sell agreement to purchase shares from your partner's heirs. The premium can be low in comparison to the lump sum that will be paid out to inheriting shareholders for share redemption. Your company may not be taxed on the lump sum, and you could avoid using your personal or business assets to buy out your partner's share of the business.

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## Overcoming gender barriers to success in business

Operating your own business has its benefits, ranging from flexibility and independence to high income-earning potential.

However, business owners also face many drawbacks, from the need to manage day-to-day operations and seek new opportunities to grow and expand to funding their own retirement, among many others. There is a great economic opportunity to support women and their businesses in Canada, but they are underserved.

### Gender differences among business owners

Female business owners tend to be motivated by the necessity to generate income to meet their financial needs, and often start a business because they see a problem and they want to provide a solution. Whereas male business owners are more motivated by economic independence—to do what they want and when they want.1 This is likely related to the finding that women tend to focus on building long-term business relationships and design their business to grow and adapt over time, while men tend to favor rapid growth in preparation for the future sale of the business.

Contrary to popular belief about risk-taking, risk tolerance is influenced more by interest, confidence and desire for independence than by gender. However, women generally prefer to make risk-related decisions to advance their business interest, while men often see risk-taking as a means to achieve financial security.[1]

## Life insurance

These strategies use life insurance to protect the company, business owners and their families. There are two general types of life insurance policies: term and permanent—each having their own variations. Both types can be used to ensure the continuity of your business and the financial protection of your family.

## Term insurance

Term insurance, such as policies for level, decreasing, increasing, or survivorship term life, can provide a tax-free lump sum payment to the named beneficiary or beneficiaries of the policy, if death occurs within the policy's term. This can cover funeral expenses, settle outstanding debts or mortgages, and help to replace the income of the deceased. For a business owner, term life insurance costs less than permanent life insurance. This reduces pressure on your capital and can help ensure you have the funds to keep your business going if you, a business partner or a key employee should die unexpectedly. There can be an option to transition to lifelong protection with permanent insurance when the time is right (convertible term), without having to answer additional medical questions. Term insurance can be used as a cost-effective solution for funding a buy-sell agreement.

## Permanent insurance

Permanent insurance, such as policies for whole, variable, universal, or survivorship life, provides lifetime coverage, as long as the premiums are paid. It can be used for estate preservation, business succession planning, supplementing retirement income, income tax reduction and paying one's final taxes and estate settlement costs.

Premiums for permanent life insurance are higher initially than for term insurance, but generally don't increase with age or if your health status changes. In addition to the life insurance component, there may be an investment component. Permanent insurance is a key component of the COLI retirement and corporate asset transfer strategies.

## Disability and critical illness insurance

You, your partners and key employees may be vital contributors to your business. But what if one of you became seriously ill or disabled and was unable to work? Such an unfortunate event could have a serious impact on your livelihood and your business.

Disability insurance is designed to help mitigate risk by providing your business with financial support if you or a business partner can no longer work or perform duties because of an illness or injury. If this were to occur, you would receive a monthly payment after a waiting period has passed.

## Overcoming gender barriers to success in business, *continued*

### Opportunities to support female business owners

For women, there are often additional barriers that hinder business development. For example, they may face greater obstacles in acquiring loans from financial institutions. These financial barriers lead many women to self-finance their business, which may prevent them from growing their business to its full potential. Consider establishing a relationship with financial institutions well before loans are needed. Become informed and understand what is required to prepare a strong business case when seeking funds. Aside from financial obstacles, there are also social issues that still limit the degree to which women can focus their full attention to the operation of their business. Women are still disproportionately responsible for managing the household and they tend to be the primary caregiver for children or other family members.[2] Consider tapping into your network for support, seek mentorship opportunities or take advantage of programs that offer support, possible funding and additional business knowledge.

### Women strongly positioned for success

Women entrepreneurs are profitable and the fastest growing segment in the U.S. Women represent a growing percentage of the work force, and the number of women who are self-employed and own an incorporated business has increased steadily in the last decade. Women are clearly thriving as business owners, but there are opportunities to support and enhance their growth.

To help female business owners, BMO has set-up key partnerships and sponsorships to support the women's market by optimizing on networking opportunities. Talk to your BMO financial professional to learn how we can help you succeed and achieve your personal and business goals.

## Funding long-term goals: retirement

Business owners face many unique challenges throughout their career. Given the uncertainties of the market, reduced diversification of assets and investments and the need to fund their own retirement, retirement planning is one of those challenges. But it does not have to be.

It is common for business owners to invest most of their assets and earnings in their business, especially during the start-up phase. For retirement, they often rely on selling the business or transferring it to a successor, or winding up the business and selling the assets. However, market uncertainties mean they should not rely on these methods to finance their retirement. By having a retirement contingency plan, business owners may avoid many potential risks.

For many people, the biggest worry about retirement planning is how to fund it. Much of a business owner's net worth is tied up in their business, resulting in a less diversified retirement portfolio. It is important to make an effort to diversify the pool of retirement capital, and there are a number of ways to achieve this.

### Simplified Employee Pension (SEP) IRA

With this plan, the contribution limits are higher than with any other type of IRA; you can potentially put away up to $56,000 per year for yourself, depending on your income. In addition, you have the flexibility to not contribute each year, depending on the cash flow needs of your business. The percentage of salary contributed to all plans must be equal, so if you have employees, you're required to invest the same percentage of their salary in their accounts as your own salary.

### Savings Incentive Match Plan for Employees (SIMPLE) IRA

Designed for small businesses with fewer than 100 employees, a SIMPLE IRA allows employees and employers to make contributions. Employees can choose whether or not to contribute, but as the employer, you must make matching contributions up to 3% of compensation or 2% non-elective contributions, so you will need to be committed to the plan year after year. In addition, the business (generally) cannot maintain another retirement plan in conjunction with a SIMPLE plan.

### Traditional or Roth IRA

Anyone with earned income (and a nonworking spouse of spouse with sufficient earned income) can open an IRA (though there are income limits for Roth IRAs). Although these types of IRAs have the lowest contribution limits, you can set one up in conjunction with another retirement plan to increase savings. Traditional IRA contributions may be deductible and the distributions may be taxable. Roth IRA contributions are nondeductible, and the withdrawals are tax free.

### Solo/Traditional or Roth 401(k)

A Solo solution allows a sole proprietor with no employees (except a spouse) to make contributions as both the employer and employee, potentially up to $56,000 (plus $6,000 catch-up if you're age 50 or older), depending on your income. Contributions as employee and employer may be fully tax-deductible, further reducing your income taxes. You can also establish the plan as a Traditional 401(k) or Roth 401(k), depending on your goals. Employees in a Traditional plan can contribute up to $19,000 pretax per year (plus catch-up contributions), commonly through payroll deductions. Business owners can make matching contributions to encourage employee participation, or profit sharing contributions based on cash flow each year, all of which are tax deductible for the business. There is no up-front tax savings in a Roth plan, but any growth and subsequent withdrawals are tax-free in retirement. Contributions to a Roth 401(k) are not subject to the income limits that apply to Roth IRAs. Employer matching contributions are pretax and may not be directed to the Roth portion.

### Defined Benefit Plans

These plans allow you to contribute more than any other type of retirement plan. An actuary uses statistics, such as the age of the participants (you and your employees), salary levels and years until retirement to calculate the contribution limits. Older business owners with younger employees can potentially maximize benefits to their own accounts based on these calculations, in some cases resulting in allowable contributions of $100,000 or more. Contributions are fully tax deductible. If you're looking to save as much as possible, and have the cash flow to do so, a defined benefit plan may be right for you.

Retirement planning is an important process that business owners must make time for throughout their career. With the variety of funding options, it is best to speak to a BMO financial professional to determine the best retirement planning strategy.

Critical illness insurance pays out a lump sum amount if diagnosed with one of a specific list of illnesses, such as cancer, heart attack or stroke. Once approved, the tax-free lump sum benefit can be used to pay off your mortgage, supplement an income of a spouse or partner who takes time off to help support you, for specialized medical treatments, or to provide funds to sustain operation of your business while you are away from managing the business recovering. Receiving this lump sum shouldn't affect eligibility for other disability benefits from the company or some government programs.

For a business owner, a disability or critical illness insurance policy could cover overhead expenses related to running your business (as could business interruption insurance) and also help pay for costs such as rents and employee salaries. It can also be used to fund a buy-sell agreement. These insurance policies provide a safety net to allow you to focus on your health while your business continues to operate without affecting your other investments and goals.

## Conclusion

You have worked hard to build your business, but an unexpected event like an illness, disability or death can have a devastating impact on you, your family and your business.

It is important to plan for the unexpected, so that recovery can take place and the business can continue to function.

Regardless of your age or stage in life, insurance should be part of a comprehensive wealth management discussion. As well as providing protection against life-changing events, insurance can be leveraged to provide tax-efficient strategies for your company and for retirement. Speak with your BMO financial professional to assess your personal and business insurance needs.

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[1] Are there gender differences among entrepreneurs?, BMO Wealth Insight, BMO Wealth Management, September 2016. https://wealth.bmoharris.com/media/resource_pdf/bmowi-gender-entrepreneurs.pdf

[2] Women in Wealth: A financial golden age has arrived., BMO Wealth Insight, BMO Wealth Management, March 2015. https://www.bmoharris.com/financialadvisors/pdf/Q1-2015-Wealth-Institute-Report-Financial-Concerns-of-Women.pdf