

BUSINESS SOLUTIONS PLAYBOOK

Uncover Missed Planning and Life Insurance Opportunities with Your Business Clients



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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, so there are a multitude of potential planning opportunities available. Are you fully addressing all the various needs of your existing business clients?

Too many financial, insurance, and benefits advisors leave opportunities on the table when it comes to their business clients. Considering that it is far easier to cross-sell an existing client than to always be prospecting for 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 to uncover concerns and needs, based on those 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 valuable employees who are key to maintaining and growing the value of my business? How do I protect the business should something happen to one of them?
- 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

Here are 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 addressing all of your planning needs as a business owner.
- There are planning aspects that we have not yet discussed, and I want to address those needs to ensure that we are not missing any areas that could cause potential issues/planning concerns down the line.
- When you own a business, there are 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

General Business Information

(You may skip the questions in this section if the client has previously provided you with this information.)

How is your business classified for federal tax purposes?

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

What is the nature of the activity of your business (e.g. manufacturing, professional services, technology)?

What percentage of the business do you own?

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

How many employees does your business have?

Protecting the Business Against the Loss of Key Employees

Yes No

Are there any individuals, including yourself, whose loss (if the individual voluntarily left or died) would pose a significant financial hardship to the business?

☐ ☐

If yes, has your business taken any steps to protect itself financially in the event of the death of one of these key employees?

☐ ☐

If yes, has your business implemented strategies that are having a meaningful impact on retaining your key employee(s)?

☐ ☐

Business Succession Planning

Do you currently have a formal plan in place?

☐ ☐

If yes, does it reflect your current goals regarding how you would ideally like to exit your business?

☐ ☐

Retirement Planning

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?

☐ ☐

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?

☐ ☐

Estate Planning

Is your estate large enough that you may be subject to federal or state estate taxes upon your death?

☐ ☐

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?

☐ ☐

Do you have non-business heirs that you want to ensure are treated fairly as part of your estate plan?

☐ ☐

If yes, do you have adequate non-business assets to accomplish your goal of treating them fairly?

☐ ☐

Is your business the primary source of financial support for your family?

☐ ☐

If yes, if something were to unexpectedly happen to you, do you feel confident that your family would be provided for?

☐ ☐

CLIENT NEEDS ANALYSIS

Listed below are the potential planning concerns covered in the questions on the previous page. Using the chart below, you can identify your client's areas of top planning concerns. In column 1, check areas of concern where 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	Check if a Top Concern
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 AND POTENTIAL PLANNING STRATEGIES

Once you have identified a planning concern for your client, it is important to 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, review the business owner characteristics in the left column to identify those that reflect your client. For each business owner characteristic that applies 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 Areas of Concern

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

CLIENT PROFILES AND POTENTIAL PLANNING STRATEGIES

Primary Areas of Concern

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

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
The client's business employs more than a few employees and does not currently offer a qualified retirement plan.	Life Insurance for Supplemental Retirement Income

Estate Planning

Business Owner Characteristics	Strategies to Consider
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

CLIENT PROFILES AND POTENTIAL PLANNING STRATEGIES

Estate Planning (continued)

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 shortfall 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 taxes¹ to make sure the client's business doesn't need to be sold and that it passes intact to his or her children.

¹The federal estate, gift, and generation-skipping transfer (GST) tax exemption amounts are all \$15,000,000 per person (indexed for inflation effective for tax years after 2025); the maximum estate, gift and GST tax rates are 40%.

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

INDUSTRY CONSIDERATIONS

Depending on the industry, there may be additional planning concerns to address for the client’s business. 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
 - Attorneys
- Certified Public Accountants (CPAs)
- Financial Services
 - Consultants
- Architecture Firms
 - Real Estate Brokers

Common Considerations and 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

The success of professional services businesses is often based on the reputation or skill of the business owners, so unless they are selling their books of business to a co-partner or successor practicing the same profession, those in professional services may have a more difficult time selling to an outside individual. 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 owners of pass-through entities. However, if the business is deemed to be a “Specified Service Trade or Business” (“SSTB”), which is the classification for most of the above-listed professional service businesses (with the exception of real estate brokers and architecture firms), then in order to qualify 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* (page 12).

²IRC Sec. 199A

INDUSTRY CONSIDERATIONS

Technology

Common Types of Technology Companies

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

Common Considerations and Potential Opportunities

Does the client's business have an employee who plays a crucial role in success, 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 success?

Potential Executive Bonus or Nonqualified 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.

Manufacturing

Common Subsectors of Manufacturing

- Transportation Equipment
- Fabricated Metal Products
- Chemical
- Printing and Related Support Activities
- Food
- Machinery
- Plastics and Rubber

Common Considerations and Potential Opportunities

Does the client's business offer competitive and incentivizing executive benefits to its key executives?

Potential Executive Bonus or Nonqualified 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 Nonqualified 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 Executive Benefits Case Study (page 15), Key Person Protection Case Study (page 17), and Business Succession Case Study (page 19).

INDUSTRY CONSIDERATIONS

Non-Profit

Common Types of Non-Profit Organizations

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

Common Considerations and Potential Opportunities

Does the client’s business offer competitive and incentivizing executive benefits to its key executives?	Potential Executive Bonus or Nonqualified 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

Non-profit organizations are tax-exempt entities under federal and state law. Since they are tax exempt, potential tax deductions for the business will not be a factor in planning considerations like they would with a for-profit business. However, these organizations 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 Nonqualified Deferred Compensation (NQDC) plans that can be offered by non-profit organizations, known as 457(f) plans, there are restrictions as a result of Section 4960 of the Internal Revenue Code. If any of the non-profit’s employees 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 on the organization on the amount of compensation in excess of \$1 million.

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 Executive Benefits Case Study (page 15) and Key Person Protection Case Study (page 17).

³IRC 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.

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 capabilities 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 in 10 years, when he plans to sell it and retire, likely will not be as much as he had originally expected. He fears he will not have as much for himself and his wife to live off and to enable travel during retirement. 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 free⁴ 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. Larry is able to take tax free⁵ loans and withdrawals to provide supplemental retirement income from the available cash value in the policy.

⁴For 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).

⁵For 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.

CASE STUDIES: POPULAR BUSINESS OWNER STRATEGIES

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
- 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-free⁵ loans or withdrawals from the policy's available cash value to supplement his or 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
Individually 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 2025): single up to \$79,000; married filing jointly \$126,000. Source: IRS Notice 2024-80, <https://www.irs.gov/pub/irs-drop/n-24-80.pdf>.

†† 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).

CASE STUDIES: POPULAR BUSINESS OWNER STRATEGIES

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.
- 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 (\$394,600 for 2025) 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,⁶ 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 the plan 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.⁷

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,⁸ 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 now has additional cash flow, which would have otherwise been paid in income taxes, that he can use to make the premium payments⁹ 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 In 2025, the maximum benefit that may be provided by a defined benefit plan is \$280,000 per year.

⁷ 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.

⁸ The amount that can be contributed to the qualified plan for each participant must be calculated by a qualified TPA.

⁹ 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 STUDIES: POPULAR BUSINESS OWNER STRATEGIES

Executive Benefits

Situation

Suzanne owns a business that designs and creates product display stands in stores. Suzanne has a good number of employees who 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 who 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. 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 Nonqualified Deferred Compensation Plan in place for him due to ERISA (Employee Retirement Income Security Act of 1974) requirements, and for the same reason, she doesn't want to establish a qualified plan that she would have to offer to all employees.

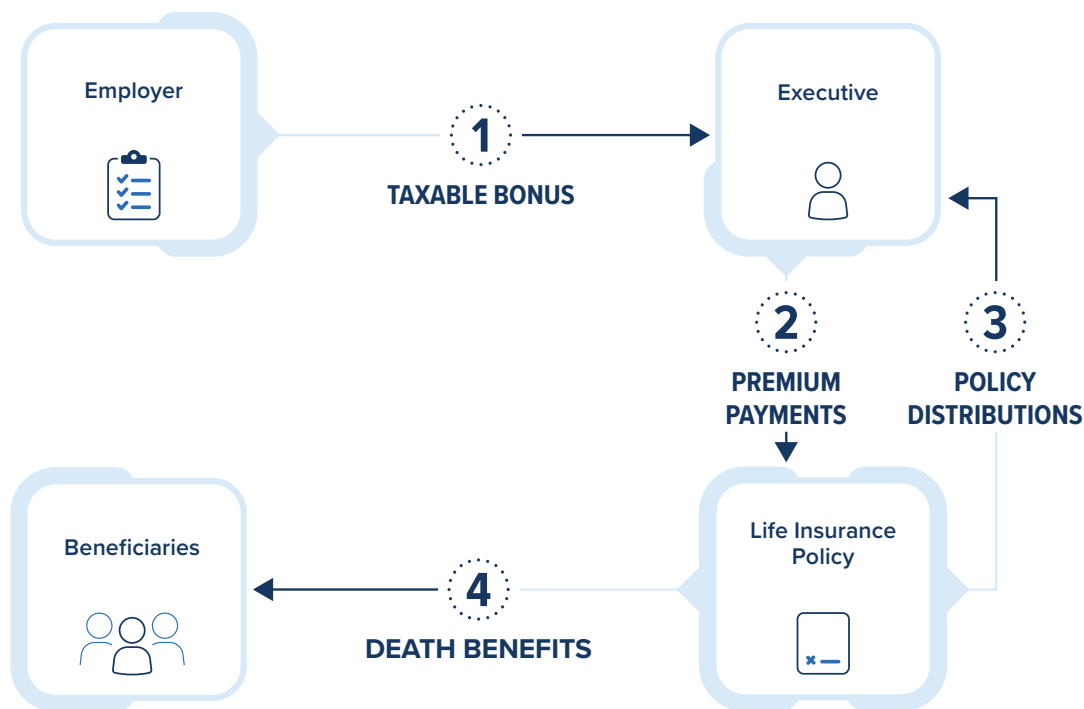
Strategy: Executive Bonus Arrangement

Suzanne establishes an Executive Bonus Arrangement for Jackson. She agrees to assist him 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 STUDIES: POPULAR BUSINESS OWNER STRATEGIES

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 bonuses¹¹ are used to provide the benefit.
- There is 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)

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Key Person Protection

Situation

Beth owns a successful technology start-up company, Alta, Inc., which has been growing rapidly since she started it 10 years ago. The success of the company has been due largely to the cutting-edge programming 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 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: Key-Person Policy Owned by the Business

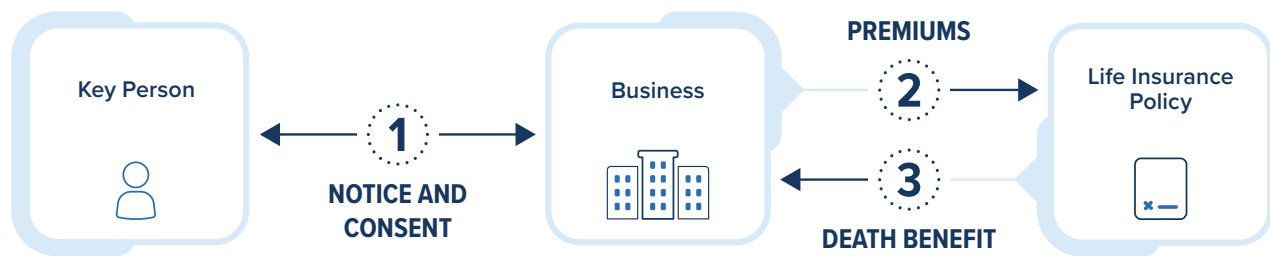
To protect Alta against the unexpected loss of Kevin, Alta provides Kevin with the proper notice and consent and takes out a life insurance policy on Kevin's life, with Alta as the owner and beneficiary. Should something unexpectedly happen to Kevin and he were to die prematurely, Alta will receive the death benefit proceeds tax free¹² 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-free¹³ loans or withdrawals to assist with the cost of securing the replacement for Kevin.

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

¹²For 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).

¹³For 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.

CASE STUDIES: POPULAR BUSINESS OWNER STRATEGIES



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 Nonqualified 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 premiums¹⁴.

¹⁴ IRC Sec. 264(a)(1)

CASE STUDIES: POPULAR BUSINESS OWNER STRATEGIES

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 children, 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 who work in the manufacturing facility, only a select few 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 10 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 children have any desire to take over the business, Benjamin must find another buyer who he knows will be able to purchase the company from him when he wants to retire.

Strategy: Key Person Policy Owned by the Business

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. 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 free¹⁵ 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-free¹⁶ loans or withdrawals to help purchase Parts-4-U from Benjamin.

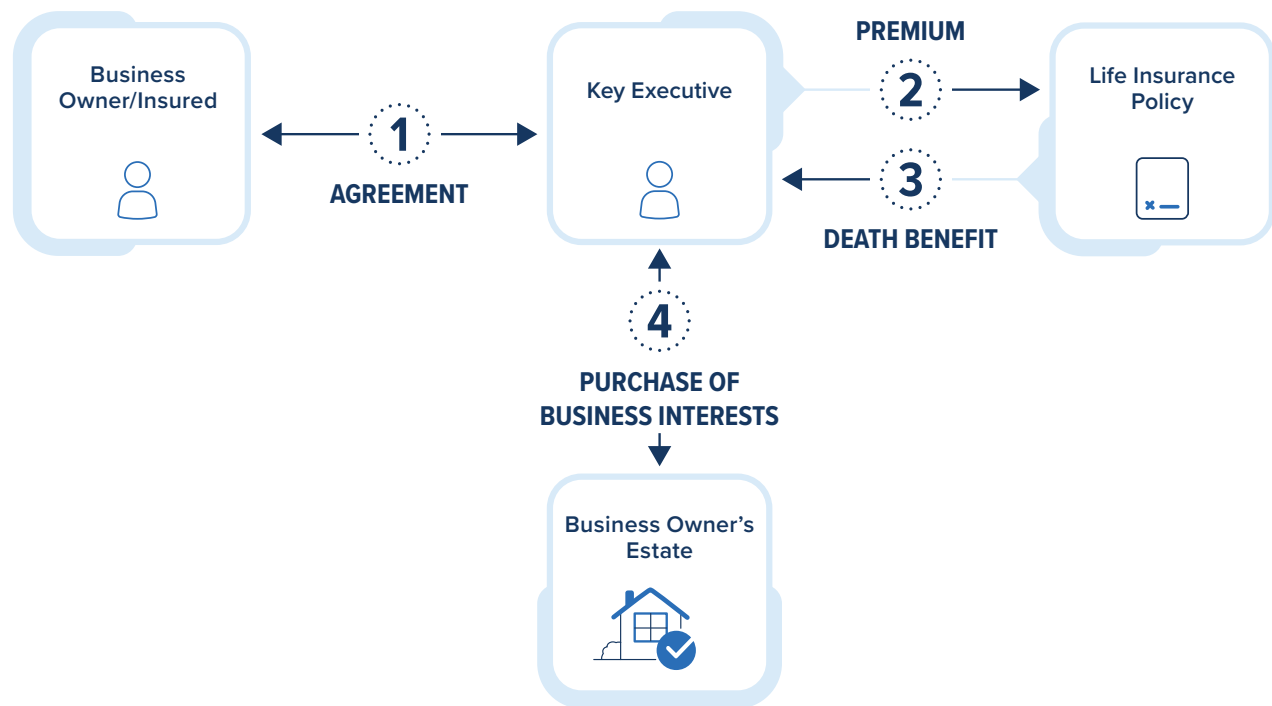
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One-Way Buy-Sell Profile

- Sole business owner
- Key executive or family member who 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

CASE STUDIES: POPULAR BUSINESS OWNER STRATEGIES

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 Nonqualified 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 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.

CASE STUDIES: POPULAR BUSINESS OWNER STRATEGIES

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.¹⁷

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 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 of 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 States¹⁸, 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.

¹⁷Business-owned policies may potentially increase the business's valuation for estate tax purposes by the amount of the death proceeds received by the business upon the death of an insured owner. See *Connelly v. United States*, No. 23-146 (U.S. 6/6/24).

¹⁸Source: U.S. Small Business Administration Office of Advocacy, *Frequently Asked Questions about Small Businesses*, July 23, 2024



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