BUY-SELL PLANNING

WHAT IS A BUY-SELL AGREEMENT?

A Buy-Sell agreement is a formal contract between business owners that lays out what will happen to each owner's share of the business upon certain triggering events, such as disability, retirement, or death. The agreement protects owners' families and helps to ensure the continuation of the business.

BENEFITS OF A BUY-SELL AGREEMENT

- Predetermined buyer
- Creates liquidity for decedent's estate
- Sets a fair selling price of shares
- Maintains harmony

<u>Other Ways to Fund a Buy-Sell:</u>

- Commercial Loan
- Sinking Fund
- Installment Purchase

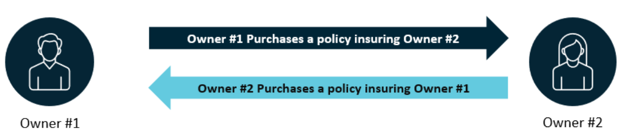
FUNDING THE PLAN

Life Insurance is the most common solution and is optimal for providing the liquidity needed for surviving owners to fund their end of the agreement. Split Dollar is a common tool for equalizing premium differentials and reducing the cost to the shareholders.

- Cost-Effective
- Immediate Liquidity via Tax-Free[1] Death Benefit
- Tax-Deferred Cash Accumulation (Permanent Insurance)
  - Potential for supplemental retirement savings

TYPES OF BUY-SELL PLANS FUNDED WITH LIFE INSURANCE

CROSS PURCHASE



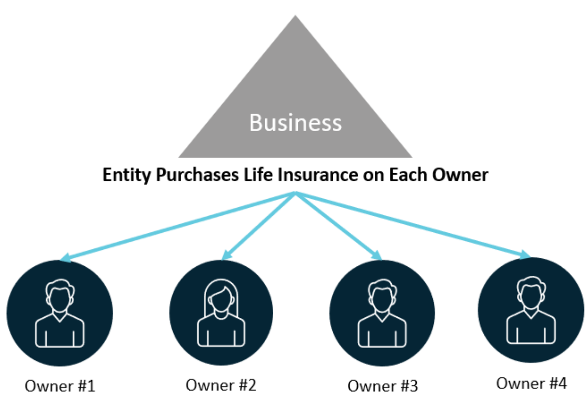
Benefits:

- Simplest Type of Plan
- Suitable with two majority shareholders

Considerations:

- Quickly becomes complex with more than two owners
- Premium share may not be equal or fair

ENTITY REDEMPTION



Benefits:

- Solves complexity of multiple owners, while still having simple design to handle 3+ owners
- Premiums are paid by the business

Considerations:

- Risk of Creditors – Life insurance is subject to creditors of the business[2]
- Premiums are not deductible by the business
- Life Insurance held to fund the plan may increase the value of the business for estate tax purposes
- ***No increase in Basis for surviving owners***

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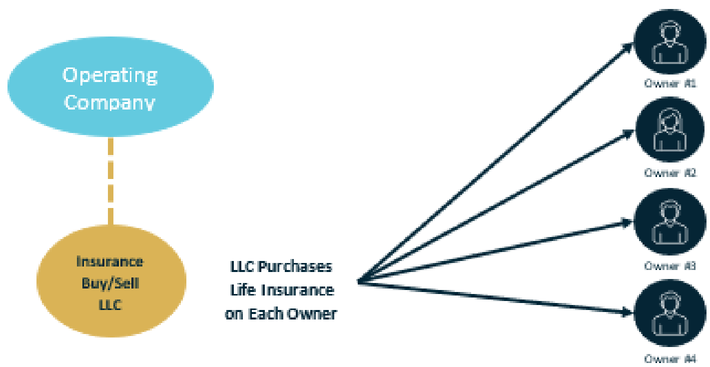
CROSS PURCHASE USING AN INSURANCE LLC:



Benefits:

- Solves basis issue, while providing the simplicity of an Entity Redemption plan[3]
- LLC is structured as a partnership in which the ownership mirrors the operating business
- Premiums may be allocated to individual owners to create equal or fair cost-splitting
- An independent manager can keep death benefits from being included in the estate

Considerations:

- Premiums are not tax deductible by the business
- Without an independent manager, death benefits may be included in the taxable estate

KEY CONSIDERATIONS

A comprehensive and properly funded Buy-Sell is a very important piece of any business owner's succession plan. Determining the right strategy is highly dependent on your individual business and personal needs. The number of owners involved in the agreement is very important, as is any personal wealth and estate planning goals. An ideal plan will integrate alongside of your personal planning and in some cases enhance it. The valuation of the company is a key component to drafting the Buy-Sell agreement and should be reviewed periodically. As with any employer-owned coverage, compliance with certain notice & consent requirements may be necessary.[4] There are many variables that can affect an individual owner and as such the advice of the company's attorney and CPA is essential to providing a sound recommendation.

1. Per IRC §101(a)
2. Creditor protection varies by state and may not be available in all situations.
3. A "special allocation" permits the partners to treat an item of income or deduction on a non-pro-rata basis provide that the special allocation has substantial economic effect and certain other regulations are observed. See PLR 200747002.
4. IRC §101(j)
5. IRC §101(a)(3) The Tax Act of 2017 included an additional hurdle for considering Transfer-for-Value issues. Care should be taken not to trigger a Reportable Policy Sale