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BUSINESS

Advanced Markets

Buy-Sell Arrangements

Succession Planning for Business Owners

Business Succession Planning

The successful growth of a business can be dependent on certain individuals, turning their death, disability or retirement into potentially devastating events if adequate planning is not in place. Buy-Sell plans allow for an orderly transfer of ownership, and life insurance can be an ideal source of funding for succession planning.

What Is A Buy-Sell Arrangement?

A Buy-Sell arrangement is a binding agreement in which one party agrees to buy and another party agrees to sell a business interest upon a specified triggering event such as death, disability, or retirement.

TYPES OF BUY-SELL ARRANGEMENTS

	Cross-Purchase	One-Way	Entity Purchase	Cross Endorsement
What is it?	Each owner agrees to buy the business interest of the other owners	Key employee agrees to buy the business from the owner	Business agrees to buy the interest of deceased owners	Each owner enters into endorsement split dollar plan with the others ¹
Funding with Life Insurance	Each owner buys a life insurance policy on the others	Key employee buys a life insurance policy on the owner	Business buys a policy on the life of each owner ²	Each business owner buys a policy on his/her own life
How does it work?	Owners enter into cross-purchase arrangement with each other	Key employee enters into a one-way arrangement with the owner	Business and each owner enter into a redemption agreement	Each owner endorses a portion of the death benefit to the other owners
Who pays the life insurance premiums?	Policy owners pay premiums, may be funded by bonus plan	Policy owner pays premiums, may be funded by bonus plan	Business pays the premiums	Each owner pays an annual "rental" charge to the others; may also be funded with bonus
Does corporate Alternative Minimum Tax (AMT) apply?	No	No	Yes (if it is a C corporation, AMT and accumulated earnings tax may apply)	No
Does insurance increase the value of the business?	No	No	Yes	No
For whom does it work best?	Businesses with three or fewer owners	Businesses with one owner	C corporations and businesses with several owners	Business owners who want flexibility for changing needs

Benefits

- **Guarantees a Buyer:** A Buy-Sell arrangement provides a guaranteed buyer upon the death, disability, or retirement of a business owner. The remaining owners are protected against the sale of a significant interest in the company to an unknown third party.
- **Creates Liquidity:** At the death of one of the owners, his or her family may need cash for ordinary living expenses. The life insurance used to fund the Buy-Sell arrangement will provide this liquidity.
- **Sets a Fair Selling Price:** A business valuation strategy is determined while all partners are active and it can usually be negotiated on an arm's-length basis.
- **Fixes the Value:** A Buy-Sell arrangement negotiated at arm's length ordinarily sets the value for estate tax purposes.

Considerations

- Clients should carefully consider the structure of the Buy-Sell plan they choose to make sure it meets their needs.
- Buy-Sell plans should be revisited on a regular basis to make sure that the current plan is still appropriate.
- The business should be re-valued on a regular basis to make sure the value set in the Buy-Sell plan stays accurate.
- Life insurance premiums are not a tax deductible expense.

1. In a Cross Endorsement Arrangement, the life insurance policy can be owned by the individual business owner or by his/her Irrevocable Life Insurance Trust (ILIT). Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. Section 101(j) of the Internal Revenue Code imposes income tax on the death benefit of life insurance contracts owned by the employer of the insured unless certain exceptions apply. In addition, the employer must show satisfaction of notice and consent requirements set forth in Section 101(j).

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