



## The Concept Exchange

# BUSINESS PLANNING

## Cross-Purchase Buy-Sell Agreement

These materials contain statements regarding the tax treatment of certain financial assets and transactions. These statements represent only our current understanding of the law in general and are not to be considered legal or tax advice by purchasers. Business tax rules and the tax treatment of life insurance are subject to change at any time. Neither West Coast Life nor its representatives offer legal or tax advice. Purchasers should consult with their legal or tax adviser regarding their individual situations before making any tax-related decisions.

Small business owners are typically focused on their company's day-to-day operations. As a result, many closely-held businesses do not adequately prepare for continuing the business after an owner's death. As a solution to what could become a significant problem, business owners may wish to enter into agreements with each other—called **buy-sell agreements**—for the orderly sale of their business interests upon retirement, disability, or death.

One type of buy-sell agreement is a **Cross-Purchase Buy-Sell Agreement**. With this method, the owners agree to buy and sell their respective business interests to one another at a set price upon retirement, disability or death.

Rather than rely on accumulating or borrowing money to fund the purchase, each owner buys life insurance on the other owners. The life insurance proceeds can be used to fund their obligations to each other. For added flexibility, the arrangement may be funded with permanent life insurance (paid for with bonuses from the business) and the policy cash values may be used to fund a buy-out at retirement if an owner wants to sell his/her interests before death.

### Advantages of a Life Insurance Funded Cross-Purchase Buy-Sell Agreement:

- Creates a market to dispose of an interest in a closely-held business at death.
- Provides the deceased owner's family with an obligated buyer at a pre-determined price to help prevent IRS valuation disputes and family litigation.
- Obligates the deceased owner's family to sell the business interests to the surviving owners. The agreement prevents unintended transfers to outsiders such as the deceased owner's spouse or children.
- Provides immediate cash to the surviving owners to complete the purchase. Each surviving owner receives the death benefit income-tax free and each receives a new income-tax basis for the acquired business interest. This results in tax savings if the interest is later sold.
- Policies may be insulated from creditors of the business (varies by state).



**West Coast Life  
Insurance Company**

A PROTECTIVE COMPANY

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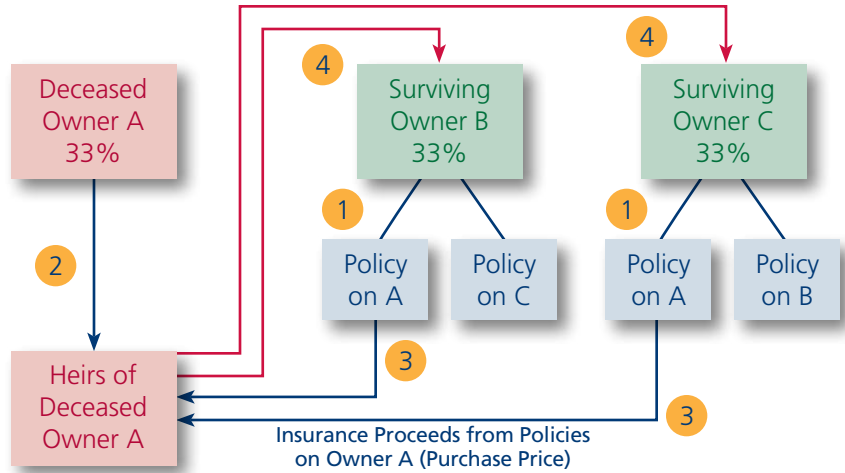
Not a Deposit	Not Insured by Any Federal Government Agency	
No Bank Guarantee	Not FDIC Insured	May Lose Value

## Some Concerns in Implementing a Life Insurance Funded Cross-Purchase Buy-Sell Agreement

- Difficult to design for more than two or three owners because it may require many policies (e.g., 12 policies for 4 owners). To reduce the number of policies, other arrangements such as an Entity Purchase Buy-Sell may need to be considered.
- Lapse may occur if an owner doesn't pay premiums when due.

## CROSS-PURCHASE BUY-SELL

### Death of Owner A



The above flow chart shows a Cross-Purchase Buy-Sell Agreement among three equal owners. **Step 1**, each Owner buys life insurance policies on each other. Each business owner is assumed to own one-third of the business (as shares or partnership units). **Step 2**, upon A's death, A's business interests pass to his/her heirs. **Step 3**, the policy death benefit on A's life is paid to Owners B and C, who then use the proceeds to purchase A's shares from A's heirs. **Step 4**, the business interests of the deceased owner are transferred from the heirs of Owner A to the surviving owners, who then become equal owners. A's estate will continue to own policies on each of the lives of B and C, which may be sold to the business or directly to the insureds.

**For more information, contact your Financial Representative.**

Life insurance is issued by West Coast Life Insurance Company (WCL), 2801 Highway 280 South, Birmingham, AL 35223.