John Hancock
LIFE INSURANCE

Client Profile
Buy-Sell Arrangements

BUSINESS PROFILE	
Type:	All closely held businesses, including sole proprietors, partnerships, S corporations and C corporations
Concern:	Desire to ensure that the business continues with the remaining owners or family members

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.

THE PROBLEM

The owners want the business to stay with the remaining owners or family members and need a way to protect the business in case of the sudden death, retirement, or disability of one of the owners.

A SOLUTION

Establish and fund a buy-sell arrangement with life insurance.

WHY ESTABLISH A BUY-SELL ARRANGEMENT?

- **Guarantee a Buyer:** A buy-sell arrangement provides a guaranteed buyer upon the death, disability, or retirement of a business owner. Providing that the plan is funded, the remaining owners are protected against the sale of a significant interest in the company to an unknown third party.
- **Create 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.
- **Set 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.
- **Fix Value:** A buy-sell arrangement negotiated at arm's length ordinarily sets the value for estate tax purposes.

Types of Buy-Sell Arrangements

The two most commonly used buy-sell arrangements are the entity purchase plan and the cross-purchase plan. The entity purchase plan, also known as a stock redemption plan, works best with multiple business owners. It is a plan in which the business owns a life insurance policy on each business owner and agrees to use the proceeds to redeem the stock of a business owner upon death, retirement or disability.

A cross-purchase plan is an arrangement in which each business owner owns a life insurance policy on the other in order to have the funds available to buy out the shares of a deceased co-owner. This type of plan works best with 3 or less business owners.

Other types of buy-sell arrangements include a one-way plan and a cross endorsement plan. A one-way buy-sell arrangement is a type of plan in which a valued employee, who may be a family member or a key person in the business, will purchase and own a life insurance policy on the life of the business owner. With a cross endorsement buy-sell arrangement (CEBS), each business owner will purchase and own a life insurance policy on his or her life. The arrangement is structured as an endorsement split-dollar plan, so that a portion or all of the death benefit can be endorsed for a "rental charge" to the other business owners to satisfy the obligation under the buy-sell agreement.[1]

JH Solutions software can illustrate all of these types of buy-sell arrangements, and a full suite of marketing materials is also available on these concepts at www.jhsalesnet.com.

TYPE OF BUY-SELL ARRANGEMENTS

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.[2]
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.[3]	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.

For additional information on Buy-Sell Arrangements, please contact your local John Hancock Representative or call the Advanced Markets Group at (888) 266-7498, option 3.

1. Each owner may desire to endorse 100% of the death benefit to the other owners during the buy-sell period. The split-dollar final regulations are silent as to whether this is permissable. Under the split-dollar final regulations, the economic benefit amounts received by each owner will be treated as rental income and taxed at ordinary income tax rates. In essence, the sum of all anticipated economic benefit amounts represents twice-taxed dollars. The present value of the combined income taxes on the sum of all anticipated economic benefits is essentially an option price that the parties have agreed to at the outset to purchase the flexibility provided by the cross endorsement buy-sell arrangement. Clients should consult their tax advisors to discuss this issue.
2. 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).
3. 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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