

Buy-sell arrangements

# Foreword to counsel with specimen documents



# Table of contents

What is a buy-sell arrangement? . . . . .	4	Community property . . . . .	25
What issues does a buy-sell arrangement resolve? . . . . .	4	Business interest held as community property . . . . .	25
How is a buy-sell arrangement funded? . . . . .	4	Life insurance policies held as community property . . . . .	25
Forms of buy-sell arrangements . . . . .	5	Forms of buy-sell structuring . . . . .	26
Establishing a business's value for buy-sell arrangements . . . . .	6	Cross-purchase buy-sell . . . . .	26
FMV . . . . .	6	What is a cross-purchase buy-sell? . . . . .	26
Book value . . . . .	6	Benefits and considerations . . . . .	27
Agreed value . . . . .	7	Structure . . . . .	27
Industry rules of thumb . . . . .	7	Set up . . . . .	27
Appraised value . . . . .	7	Upon A's death . . . . .	28
Formula value . . . . .	8	Upon B's death . . . . .	28
Capitalization of earnings . . . . .	8	Preface to cross purchase specimen agreement . . . . .	29
Life insurance issues with buy-sell agreements . . . . .	9	Specimen cross purchase agreement . . . . .	29
Business taxation issues . . . . .	9	Entity redemption buy-sell . . . . .	35
Notice and consent requirements for employer-owned life insurance (EOLI) . . . . .	9	What is an entity redemption buy-sell? . . . . .	35
Transfer for value . . . . .	12	Benefits and considerations . . . . .	35
Transfer for value traps . . . . .	13	Structure . . . . .	36
Selecting the form of basic buy-sell . . . . .	14	Set up . . . . .	36
What type of business entity? . . . . .	14	Upon A's death . . . . .	36
How many owners, or shareholders? . . . . .	17	Upon B's death . . . . .	37
What are the owner percentages, ages and health? . . . . .	18	Preface to entity redemption specimen agreement . . . . .	38
Other issues . . . . .	18	Specimen resolution authorizing entity redemption agreement . . . . .	38
Dividend versus sales treatment . . . . .	18	Specimen entity redemption agreement . . . . .	39
Cross purchase . . . . .	20	Wait-and-see buy-sell strategy . . . . .	44
Special considerations . . . . .	20	What is a wait-and-see buy-sell agreement? . . . . .	44
Tax treatment of premiums . . . . .	20	Why is the order of the options so important? . . . . .	44
Surviving owners tax basis step-up . . . . .	20	When do you use the entity redemption option? . . . . .	45
Ownership allocation after a death . . . . .	21	Why, if the entity redemption is utilized, must there be a complete redemption? . . . . .	45
Elimination of earnings and profits . . . . .	21	Preface to wait-and-see buy-sell agreement . . . . .	46
Effect of life insurance funding on the accumulated earnings tax . . . . .	21	Specimen resolution authorizing wait-and-see buy-sell agreement . . . . .	46
Family corporations — problems with entity redemption . . . . .	21	Specimen wait-and-see buy-sell agreement . . . . .	47
Family attribution . . . . .	22	One-way buy-sell strategy . . . . .	53
Bequest . . . . .	22	What is a one-way buy-sell? . . . . .	53
Waiver of family attribution rules . . . . .	23	Preface to specimen one-way buy-sell purchase agreement . . . . .	54
Valuation of business interest — does the buy-sell arrangement help? . . . . .	23	Specimen one-way buy-sell purchase agreement . . . . .	54
		Insured's acknowledgment of disclosure and consent . . . . .	59

# Buy-sell agreements: The art and science of business continuation

Before we dive into the specifics of buy-sell arrangements it is important to know that the U.S. Supreme Court decided the Connelly case (Estate of Connelly v. US, 144 US 1406 (2024)), which fundamentally affects all business owners who have or are considering a life insurance funded buy-sell arrangement. Specifically, buy-sell agreements commonly referred to as “entity purchases” or “stock redemptions” are most affected. The decision has muddied the waters around buy-sell agreements by reversing generally accepted principles long held by the financial services community. An additional question now for buy-sell strategies is:

## **When is it proper for financial professionals to consider a life insurance funded stock redemption (entity purchase) buy-sell agreement for their clients?**

To review, in Connelly v. United States, the U.S. Supreme Court addressed the narrow question of whether a corporation’s fair market value, where the corporation has an obligation to redeem a decedent owner’s shares, is impacted by life insurance proceeds received by the corporation and committed to funding the redemption for estate tax purposes. The Court unanimously held that the corporation’s redemption obligation is not a liability that reduces the estate tax value of the decedent’s shares and that the death benefits received by the corporation must be included as part of the estate tax valuation of the business.

As a result of the Connelly decision, when selecting a buy-sell arrangement it should be clear that if the business, corporation or entity owns life insurance contracts on the lives of the owner(s) and the owner dies, the date of death value of the business will be increased by the death proceeds that are received and the shareholders will have a larger amount to redeem than merely the share value prior to the date of death. This is a departure from the holding in the Estate of Blount, T.C. Memo. 2004-116, *aff’d*, 428 F.3d 1338 (11th Cir. 2005) where for business valuation purposes an “offsetting” liability was allowed to lessen the receipt of the impact of the death proceeds by the company. It is critical to remember that when contemplating a buy-sell arrangement that stock redemptions or entity purchases funded with life insurance will produce higher date of death valuations than other types of arrangements. We will review all buy-sell arrangements and their impacts on clients in this foreword to counsel.

# What is a buy-sell arrangement?

A buy-sell arrangement is an arrangement between business owners, a business owner and potential future owner, or between business owners and the business, to transfer ownership of a business interest upon death, disability or retirement. In a typical buy-sell arrangement, each business owner agrees to sell his or her interest according to specific terms of the business or other business owners.

## What issues does a buy-sell arrangement resolve?

- **Guarantees a buyer:** Provides a guaranteed buyer of the business upon an owner's death, retirement or disability.
- **Creates liquidity for deceased owner's family:** Can require the business, or surviving owners, to purchase the deceased's owner's interest, allowing liquid assets to be distributed to the decedent's family.
- **Avoids conflict of interest between the surviving owner(s) and the deceased owner's family:** A deceased owner's family may want income from the business, while the surviving owners may want to reinvest all excess profits back into the business. A fully executed buy-sell arrangement will avoid these types of issues.
- **Avoids valuation difficulties:** Typically, a buy-sell arrangement helps determine the value of the business for buyout or estate tax purposes.
- **Solves lack of marketability issues:** There is no established market for closely held stock and generally there is no third party who would be willing to purchase an interest, particularly a minority interest, in a closely held business immediately after the death of an owner-employee.

## How is a buy-sell arrangement funded?

There are four methods to fund a buy-sell arrangement and resulting considerations for each:

1. **Unfunded/Installment purchase:** The surviving owners or business purchases the deceased owner's ownership by installment. The installment method may put a strain on the cash flow of the business, or purchaser, and drastically affect the business's profits.
2. **Side fund:** The business or the owners put money in a side fund to purchase the deceased or retired owner's share upon an event (death, disability or retirement). With a side fund, the business may not have time to accumulate assets to fund the purchase. Retention of assets in a C corporation can trigger accumulated earnings tax.
3. **Third-party financing:** The business or the owners plan on borrowing funds from a third party to fund the buy-sell arrangement. Third-party financing can be difficult to secure after the death of an owner. It may also restrict the ability to secure additional loans for other business needs, such as expansion or working capital.

**4. Life insurance:** The business or the owners purchase life insurance on the lives of the owners to fund the buy-sell arrangement. If a permanent policy is used, the cash value may assist in the buyout at retirement. Using life insurance can be difficult if an owner is in poor health, since the premiums would likely be higher than cost justifiable.

### Forms of buy-sell arrangements

<b>Cross purchase</b>	An arrangement between or among the business owners themselves. Generally, each owner is the owner and beneficiary of a life insurance policy on each of the other owners. Upon the death of an owner, each of the remaining owners uses the death benefit from the life insurance policy purchased on the decedent to purchase a proportionate share of the decedent's ownership.
<b>Entity redemption</b>	An arrangement between a business and the business owners. Each owner agrees to sell his or her interest to the business upon their death. The business agrees to buy the owner's interest. The business owns insurance on each owner's life, pays the premiums, and is the beneficiary of each policy. The value of the policy owned by the business is included in the business's date of death value if the insured owner dies.
<b>Wait and see</b>	The business owners own policies in a wait-and-see buy-sell arrangement, but the business has first option to purchase the shares of the deceased owner. If the business doesn't purchase, then surviving shareholders have an option to purchase the shares. If shareholders don't purchase, the business is obligated to redeem the remaining ownership. Owners usually lend the remaining insurance proceeds to the business to complete the purchase. In return, the business issues interest-bearing notes back to the owners.
<b>One way</b>	The sole owner of a business enters into a buy-sell arrangement typically with either a key employee or a family member. The key employee or family member is the owner and beneficiary of a policy on the business owner. The business bonuses premium payments to the key employee and upon the death of the business owner, the key employee or family member is required to purchase the ownership from the estate of the deceased owner. The key employee or family member then becomes sole owner of the business.
<b>Cross endorsed</b>	A cross-endorsed buy-sell is an arrangement between the owners of a company where each business owner purchases a policy on his or her own life and "rents" a portion of the death benefit to the other owners. Each owner recognizes rental income but retains access to the cash value in his or her policy. This strategy allows ownership of the insured's own policy.
<b>Lifecycle</b>	The lifecycle buy-sell arrangement is designed to facilitate the transfer of ownership of corporations. This strategy combines the advantages of both entity-redemption and cross-purchase without the transfer for value problems often encountered. In addition, the funding can be combined with living buyout or retirement accumulations. <b>(Please see Lifecycle foreword to counsel.)</b>

# Establishing a business's value for buy-sell arrangements

If the purpose of the valuation for a business is for a transfer of interest, then typically an analysis of the "fair market value" (FMV) is required. An assessment of the FMV can be estimated under various means. The IRS outlines guidelines to determine FMV, but value can also be determined under an array of other methods, some more accurate than others. The ultimate goal is to align the purpose of the valuation with the various method to get an estimate of value.

## IRS definition of FMV

According to the IRS, the FMV is the price that the property would sell on the open market. For a business's value, it is typically defined as "the hypothetical price a willing buyer and willing seller, with mutual knowledge of all relevant facts and not acting under any compulsion, would agree upon for the company."<sup>1</sup>

The IRS considers eight factors in determining the value of a closely held business:<sup>2</sup>

1. Nature and history of the business
2. General economic outlook and specific industry outlook for the business
3. Book value and financial condition of the business
4. Past, present and future earnings of the business
5. Dividend paying history and capacity of the business
6. The business's goodwill
7. Prior sales of stock and the number of shares sold
8. Market price of similar publicly traded companies

There is substantial ambiguity as to how the value of the business is determined. Further, if the shares of the business are redeemed by the business, any life insurance death proceeds held by the business must be included in the date of death valuation.

## Book value: An asset-based approach to valuation

Book value is essentially the stated assets less liabilities of a business.

Determining the value of a business by this technique is difficult. Because stated book value often lists assets at cost, using book value without any modifications can misrepresent the business's value. Therefore, at a minimum, you should look at the actual fair market value of the assets to determine if there are any large discrepancies.

An examination of the business should be made to determine whether or not assets are a substantial income-producing factor. If assets are a substantial income-producing factor, then valuing the business based on the modified book value has some credibility. If assets are not a substantial income-producing factor, valuing the business based on book value fails to recognize the true value of the business.

1. Publication 561 (Rev. Feb. 2000).

2. Rev. Rul. 59-60 1959-1 C. B. 237, Section 4.

An examination of the profit or loss of the business should also be undertaken. A business that has substantial assets but produces negative income amounts should probably not be valued at net book value.

One of the main considerations is establishing a date to determine the value of the company. This is especially true if insurance proceeds are to be received by the company upon the death of the owner. Insurance proceeds are included in the assets of the business and increase the book value of the company.

### **Agreed value**

The agreed value method establishes a stated value inside the buy-sell arrangement. The value is generally subject to an annual review process and can change by adding a new value amendment onto the arrangement.

An alternative valuation mechanism may need to be determined if a significant amount of time elapses without the business owners agreeing to a new value.

For example, the buy-sell arrangement may provide a stated value. It may also state that if no modifications are made to that value within two years prior to the valuation date, outside appraisers will be used. This helps prevent business owners forgetting to update the stated value and it becoming too low in value to use in the buy-sell arrangement. Further, any agreed upon valuation must contemplate the value of any death proceeds owned by the business as part of the buy-sell arrangement.

### **Industry rules of thumb**

Industry rules of thumb often provide a useful “back of the cocktail napkin” indication of value and are usually based on industry benchmarks or historical transaction multiples. Rules of thumb can give a quick answer to a difficult question, and often business owner clients refer to these in estimating their business’s value. However, they are very limited in that they do not take into consideration information specific to the business itself (e.g., location, employment contracts, branding, intangibles). Therefore, it is typically not an accurate assessment of FMV.

### **Appraised value**

The appraised value method uses a qualified independent third party to make an appraisal of the business at a specific date. Generally, the arrangements establish a situation where either:

1. The two parties agree upon one specific appraiser.
2. Each party hires their own appraiser, and the two appraisals are compared.

If an equitable price cannot be arrived at between the two appraisals, a third appraisal or an arbitration system establishes the appraised value. Although costly, the appraised value is the most accurate way to establish the value of the business. The appraiser should take into account any life insurance death proceeds owned by the business as part of the appraised value.

## Formula value

The formula valuation method establishes a specific formula inside the buy-sell arrangement to determine the value of the business. This approach can produce fairly accurate results, but it takes more planning than the other methods of valuation.

- Items, such as the capitalization rate and how the income factor is determined, must be decided before the buy-sell arrangement is drafted
- Any modifications to the income number must be discussed and laid out in the buy-sell arrangement itself
- If these items are taken into account and an accurate formula is established, the value itself will not become obsolete should the owner fail to review the valuation annually – as might happen with the agreed value method
- Any life insurance proceeds receivable by the company on the death of an owner must be taken into account to determine its date of death value

## Capitalization of earnings

Under this typical formula method, earnings over time are averaged or weighted to establish an earnings figure to which a capitalization rate is applied. A capitalization rate is a risk factor. This calculation takes the annual income number and divides that number by the capitalization rate. This produces a total value figure based on the income and the anticipated risk. Further, if insurance is owned by the business the capitalization of earnings calculation must include any death proceeds received by the company.



# Life insurance issues with buy-sell arrangements

## Business taxation issues with employer-owned life insurance

Event	Ramification
Contributions	Who pays the premium?  <b>Employer:</b> Generally, not deductible <b>Employee:</b> Employer: Deduction for bonus* Employee: Bonus taxed as income
Accumulation	Generally, tax deferred
Withdrawals	Business never age 59½, DEFRA
Death of insured	Generally, income tax-free, but watch out for: <ul style="list-style-type: none"><li>• EOLI: Notice and consent</li><li>• Transfer for value</li></ul>

\*Only for C corporations.

## Notice and consent requirements for employer-owned life insurance (EOLI)

Because business owners themselves are often employees of their business, it's critically important to understand the Notice and Consent requirements for EOLI contracts.

An EOLI contract is defined as a life insurance policy issued after August 17, 2006, that is owned by a person engaged in a trade or business and under which such person (or a related person) is directly or indirectly a beneficiary under the contract, and insures an employee of the trade or business of the policy owner or a related person (collectively the "applicable policyholder") on the date of the contract's issuance.<sup>3</sup> Unless an exception applies, an applicable policyholder must include in gross income the death benefits received under an EOLI contract that exceed the total premiums and other amounts paid by the policyholder for the contract.

**There are two exceptions:** The first is based upon the insured's status as an employee. The exception will apply if the insured under the contract was (1) an employee at any time during the 12 months prior to his or her death, or (2) a director or a highly compensated employee or individual at the time the contract was issued.<sup>4</sup>

The second exception is that the death benefits are either (1) paid to the insured's estate, family members, or other designated beneficiaries (other than the policyholder) or a trust for the benefit of any such individuals, or (2) used to purchase an equity (or capital or profits) interest in the applicable policyholder from any person described above. However, these exceptions are applicable only if the notice and consent requirements are met before the issuance of an EOLI contract.

3. IRC §101(j). For this purpose: (1) a "related person" is any person with a relationship to the policy owner as specified in IRC §§267(b), 707(b)(1), 52(a) or 52(b); and (2) an "employee" is a U.S. citizen or resident who is an officer, director or certain highly compensated employees as defined in IRC §414(q).

4. For this purpose, (1) a "highly compensated employee" is defined in Code §414(q) but ignoring paragraph (1)(B)(ii) (i.e., any employee who is a 5 percent owner or had compensation from the employer in excess of \$115,000 (inflation adjusted)), and (2) "highly compensated individual" is defined in Code §105(h)(5), but substituting 35 percent for 25 percent (i.e., an individual who is (a) one of the five highest paid officers, (b) a shareholder who owns (with the application of the constructive ownership rules of IRC §318) more than 10 percent of the employer's stock, or (c) among the highest paid 35 percent of all employees).

As a general rule, notice and consent is required whenever a business entity will own a life insurance policy – including wholly owned corporations and sole proprietorships.

- Entity redemption buy-sell: The business owns the policy insuring the business owner and receives the death benefits to fund the owner's buyout.
- Lifecycle buy-sell: A separate partnership or LLC is used to hold life insurance on the owners of an operating business to fund the buy-sell of the operating business.
- Key person life insurance: A business owns a policy to protect it against the loss of a key employee, owner, director, etc.
- Changes or exchanges of grandfathered policies: any change to a grandfathered policy or an Internal Revenue Code (IRC) §1035 exchange of a grandfathered policy for a new policy if there is (1) a material increase in the death benefit or (2) another material change in the policy.

The Internal Revenue Service (IRS) states life insurance policies issued in cross-purchase arrangement generally will not qualify as EOLI contracts for purposes of IRC §101(j).<sup>5</sup>

To fit within any exception to EOLI taxation, policyholders must satisfy certain notice and consent requirements prior to issuance of the EOLI contract. The IRS issued the following guidance regarding compliance with the notice and consent requirements:<sup>6</sup>

**Notice.** The employee (including business-owner employees) must receive written notification that the applicable policyholder intends to insure the employee's life, reasonably expects to purchase a specified maximum amount of life insurance (stated either in dollars or as a multiple of salary) on the employee during the employee's tenure, and will be a beneficiary of any proceeds payable upon the death of the employee.

**Consent.** The employee must provide written consent to being the insured and to the continuation of coverage after termination of the insured's employment. The contract must be issued (1) within one year after the employee's consent or (2) before the termination of the employee's employment, whichever is earlier.

EOLI compliance is the policyholder's responsibility. In any potential EOLI situation involving a Minnesota Life or Securian Life policy, there are two steps:

1. The employer must sign a copy of Minnesota Life's form F66015 or Securian Life's form FSL-66015, "Employer Notification Regarding the Potential Taxation of Death Benefits" before the policy is issued and return it to the financial representative.

This form simply notifies the employer of its potential obligations under these rules. It does not relieve the employer of its obligation to obtain a signed notice and consent from the prospective insured.

5. Notice 2009-48.

6. Id.

2. The client should discuss the EOLI rules with an attorney and, if the EOLI rules apply, obtain a signed notice and consent from the insured before the policy is issued. There is a sample “Insured’s Acknowledgement of Disclosure and Consent – Employer Owned Life Insurance Policy” at the end of this foreword to counsel. It is the employer’s obligation to obtain a signed form from each prospective insured before the policy is issued. The employer should retain these signed forms and file them along with their life insurance policies. The employer must also report these policies to the IRS annually by attaching completed Form 8925 to the employer’s annual income tax return.

While the IRS presumes that an employee will receive a separate form for notice and consent, a recent Private Letter Ruling (PLR) held that a separate document was not required where the totality of the applicable policyholder’s documentation in connection with the EOLI contract evidenced that all the notice and consent requirements were met prior to contract issuance (specifically a buy-sell agreement and a life insurance application, both executed by the insured employee prior to issuance of the contract, which together contained all the required notice and consent information).<sup>7</sup> Accordingly, for existing EOLI contracts, an employer may be able to evidence notice and consent without separate documentation if it can demonstrate that all required notice and consent information was included in one or more documents that were provided to and/or executed by the insured employee prior to the contract’s issuance. For newly issued contracts, however, obtaining a separately executed notice and consent form from the insured employee will more easily and clearly document compliance.

In addition, EOLI policyholders must file Form 8925 with their annual federal tax returns for each year that an EOLI contract is owned to report certain information regarding EOLI contracts, including the number of employees insured and the total insurance held under EOLI contracts and the number of nonconsenting insured employees (if any). The policyholder must also keep whatever records may be necessary to evidence compliance.

The only situations in which the IRS will not challenge inadvertent failures to satisfy the notice and consent requirements are if:<sup>8</sup>

- The applicable policyholder made a good faith effort to satisfy the notice and consent requirements (e.g., maintains a formal system for notice and consent for new employees); and
- The failure to satisfy the requirements was inadvertent; and
- The failure to obtain the notice and consent was discovered and corrected by the due date of the tax return for the taxable year in which the EOLI contract was issued (failure to obtain consent cannot be corrected if the insured employee has died).

Otherwise, removing the taint of an improperly issued EOLI contract often involves (1) cancelling the existing policy and issuing a new one or (2) affecting a material increase in the policy death benefit or other material change in the contract. The notice and consent requirements must be satisfied prior to the issuance of a new policy or to a material change in an existing policy.

7. PLR 201217017.

8. Notice 2009-48.

## Transfer for value

The transfer for value rule, contained in IRC section 101(a)(2), provides:

“In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from gross income by [the beneficiary of death proceeds under a life insurance contract] shall not exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid by the transferee.”

The transfer for value rule provides that when a policy is transferred for valuable consideration, the death proceeds received in excess of the consideration paid are taxed as ordinary income (as opposed to tax-free under the general rule for life insurance proceeds).<sup>9</sup> Consequently, running afoul of the transfer for value rule must be avoided at all costs.

Below are some points to remember:

- It does not matter whether the policy is term or permanent insurance
- It applies to group as well as individually purchased life insurance coverage
- The method how the policy is transferred is irrelevant
- It can apply even if ownership of a policy has not been transferred
- A mere shift in an interest in the contract may be sufficient to trigger the rule
- For the rule to apply there must be both 1) a transfer of a policy or an interest in a policy, and 2) valuable consideration paid for that transfer to the transferor.

There are five safe-harbor exceptions that may shelter a transfer from the transfer for value rule penalty (even if there is a transfer for valuable consideration). The safe harbors are:<sup>10</sup>

1. Transferor's basis (“in whole or in part”);
2. Transfer to the insured;
3. Transfer to a partner of the insured;
4. Transfer to a partnership in which the insured is a partner; and
5. Transfer to a corporation in which the insured is a shareholder or officer.

### Please note:

- Transfers to a stockholder (other than the insured) are not protected and will trigger the transfer for value rule.
- Transfers to a partnership in which the insured is a partner and to a partner of the insured are statutory exceptions to the transfer for value rule under Section 101(a)(2)(B). This means that by having a partnership own the life insurance which funds the buy-sell, all transfer for value traps are avoided.

9. IRC §101.

10. 101(a)(2)(A) and (B).

### **Transfer for value traps**

If the owners wish to change from entity redemption to a cross-purchase arrangement, the corporation will transfer the policies owned on the life of the owner to their other owners. The problem is that this transfer will cause the majority of the insurance proceeds to become taxable under the transfer for value rule. The transfer of a policy to a co-owner is treated as a sale for valuable consideration and therefore the transfer for value rule would apply, creating taxable income at death.

# Selecting the form of basic buy-sell

The two most common, and typically easiest to implement, forms of buy-sell agreements are the cross purchase and entity redemption

There are three basic questions a financial professional needs to ask to determine whether to use a cross-purchase or entity redemption buy-sell arrangement:

1. What type of business entity?
2. How many owners, or shareholders?
3. What are the owner percentages, ages and health?

## 1. What type of business entity?

This first question is important because of basis increase for the owners upon the death of an owner. A detailed discussion of the characteristics of these entities is beyond the scope of this guide. What is important to know is that partnerships, S corporations and LLCs (taxed as either a partnership or S corporations) are pass-through entities, meaning that losses and profits are taxed directly to the shareholders/owners.<sup>11</sup> This becomes an issue when determining whether remaining shareholders will receive a step-up in basis for the purchase of a departing shareholder's interest.

<b>Cross purchase</b>	Step-up in basis for shareholders of C corporations and pass-through entities.
<b>Entity redemption</b>	Possible step-up in basis for shareholders of pass-through entities only.

## Entity redemption with S corporation

When an S corporation uses entity redemption, the death benefit proceeds go to the corporation, and are included in the date of death value of the company and the remaining shareholders will generally receive a pro rata basis increase. This is because the corporation and its owners share both tax bracket and basis. Income to the entity from the life insurance death benefit (which is realized but not taxed) increases the owners' and entity's basis.<sup>12</sup> When the entity applies the life insurance death benefit proceeds toward the purchase of the deceased shareholder's stock, the remaining shareholders receive a pro rata step-up in the basis of their own stock.

11. IRC Sec. 1366.

12. IRC Sec. 101(a)(1).

### EXAMPLE

- A, B, C are co-equal shareholders of a \$3 million S corporation and each has \$1 million basis in the corporation
- Corporation owns a \$1 million life insurance policy on each shareholder (with the proper notice and consent under §101(j))

If A dies, the corporation will receive \$1 million in federal income tax-free death benefit. The business will now be worth \$4 million. Each shareholder's basis in the S corporation will increase by \$333,333 (including A).<sup>13</sup> So, once the corporation redeems A's stock, B and C will be 50/50 owners of a \$4 million S corporation. B and C will each have a basis of \$1,333,333 and the dollar value of their interests will be \$2,000,000 each. If B and C sell the company to D for \$4 million, B and C will each have \$166,667 in capital gains (\$2M value less their \$1.33M basis).

### Entity redemption with a partnership

Partnerships are pass-through entities similar to S corporations. Basis is also a main consideration for a partnership.

- Like S corporations, a partner's basis is affected by contributions, distributions and income or loss.
- Unlike S corporations, because of the ability to specially allocate income within a partnership, the basis discrepancy between entity redemption and cross purchase can be eliminated. **(Please see Lifecycle foreword to counsel.)**

### Entity redemption with a C corporation

C corporation shareholders have both separate taxation and basis from their corporation. When a C corporation receives corporate-owned life insurance death benefit proceeds, the shareholder's basis does not increase, but the dollar value of their interests increases.

<sup>13</sup> A "short year" election terminates the deceased shareholder's tax year and right to allocation of a portion of the death benefit. The corporation receives the death benefit in a new tax year and then buys out the decedent's estate. The result being the death benefit is fully allocated to the surviving shareholders, thus increasing their basis by the entire amount. Short year election is only available to cash basis S corporations. In this example, B and C would receive a \$500,000 basis increase each instead of \$333,333.

**EXAMPLE #1: WITHOUT AB CORPORATION OWNING LIFE INSURANCE FOR STOCK REDEMPTION**

- Assume shareholders A and B each own 50 percent of AB Corporation. Assume both have a basis in their stock of \$10,000
- Assume the corporation is worth \$100,000

**AB Corporation value = \$100,000****Shareholder A**

Value \$50,000

Basis \$10,000

**Shareholder B**

Value \$50,000

Basis \$10,000

- Assume the corporation enters into an entity redemption arrangement with the shareholders
- Also assume that A dies first and the corporation redeems A's stock
- If the arrangement was fully funded on A's life, B now owns 100 percent of the outstanding stock of a corporation worth \$100,000
- B's basis is still only \$10,000
- If B now sells his or her stock for \$100,000, B would recognize a gain of \$90,000 (\$100,000 - \$10,000)

**EXAMPLE #2: AB CORPORATION OWNING LIFE INSURANCE FOR STOCK REDEMPTION**

- Assume shareholders A and B each own 50 percent of AB Corporation. Assume both have a basis in their stock of \$10,000
- Assume the corporation is worth \$100,000
- Assume the corporation owns \$50,000 of insurance on the lives of A and B and B dies

**AB Corporation value = \$150,000****Shareholder A**

Value \$75,000

Basis \$10,000

**Shareholder B**

Value \$75,000

Basis \$10,000

- Assume the corporation enters into an entity redemption arrangement with the shareholders
- Also assume that B dies first and the corporation redeems B's stock
- If the arrangement was fully funded on B's life, A now owns 100 percent of the outstanding stock of a corporation worth \$150,000
- A's basis is still only \$10,000
- If A now sells his or her stock for \$150,000, A would recognize a gain of \$140,000 (\$150,000 - \$10,000)



**Cross purchase with a C corporation**

In order for surviving shareholders in a C corporation to receive a step-up in basis for the purchase of a departing shareholder’s interest, a cross-purchase buy-sell or wait-and-see buy-sell must be used. In the cross-purchase buy-sell, the shareholders themselves own the policies on each other’s lives and receive the death benefits or cash values as individuals. Thus, when surviving shareholders use their personally owned life insurance policy proceeds to purchase a departing shareholder’s stock, the buyers get an increase in basis – because it was purchased directly from decedent’s estate, which received a step-up on basis at the date of death.

**EXAMPLE: CROSS PURCHASE**

**Let’s assume the same facts as above for entity redemption, now viewing it as a cross-purchase arrangement:**

- A owns a \$50,000 policy on B’s life and B would own a policy of the same amount on A’s life
- At A’s death, B would use the \$50,000 of insurance proceeds to purchase A’s stock
- Just as in the entity redemption arrangement, B owns 100 percent of the stock. But B’s basis or investment in the stock is now \$60,000 (initial investment of \$10,000 plus subsequent investment of \$50,000)
- If B now sells his or her stock, B recognizes only \$40,000 of gain (\$100,000–\$60,000)

In this example, if A and B enter into a cross-purchase arrangement, the insurance policy that B owns on A should not be included in A’s estate. However, the value of the policy that A owns on B is included in A’s estate if A dies first. The amount included is approximately equal to the cash value.

In summary, a cross-purchase arrangement generally gives surviving shareholders a higher basis and less taxable gain if they sell during life. However, if the surviving shareholders retain their stock until death, they receive a step-up in basis to fair market value and either arrangement gives exactly the same result.

**Cross purchase with an S corporation and partnership**

An S corporation and partnership cross-purchase buy-sell arrangement works exactly the same as with a C corporation.

**2. How many owners, or shareholders?**

<b>Entity redemption</b>	Requires one policy per shareholder.
<b>Cross purchase</b>	Requires every shareholder to own a policy on every other shareholder.

In an entity redemption buy-sell arrangement, only one policy on each of the shareholders is required. So, for seven shareholders, seven policies are required.

However, for a cross-purchase buy-sell arrangement, each shareholder must own a policy on each of the other shareholders. So, for seven shareholders, 42 policies are required. This is almost an impossible administrative burden.

The number of policies needed in a cross-purchase buy-sell arrangement can be determined by the following formula:  $N \times (N-1)$ , where N = number of shareholders.

### 3. What are the owner percentages, ages and health?

#### Percentages of ownership

Large variances in ownership interests will complicate buy-sell arrangements. When an owner has substantially more of the business than other owners, funding will become problematic.

<b>Entity redemption</b>	Becomes an issue with an S corporation because of the pass-through taxation. In an S corporation, the minority shareholder may only receive a pro rata step-up in basis. If he or she owns 10 percent of the corporation, he or she will only get a 10 percent basis increase but may end up owning 100 percent of the corporation. The subsequent sale of the corporation may result in large capital gains tax exposure.
<b>Cross purchase</b>	The minority shareholders may not be able to afford the life insurance premiums on the majority owner and may require additional bonuses to pay for the premiums.

#### Entity redemption – premiums pooled

Since the corporation is paying the premiums, the cost of the insurance is divided among the shareholders according to the percentage of stock they own.

#### Cross purchase – premiums not pooled

Each shareholder pays for enough insurance to buy out the other shareholders.

#### EXAMPLE

- A 25-percent owner pays for enough insurance to buy out the 75-percent owner, while the majority shareholder only pays for enough insurance to buy out the minority shareholder.
- The burden is greater on the minority shareholder. Even if there are two equal shareholders, the premium burden is not necessarily evenly split in the cross purchase buy-sell arrangement.

#### Ages and health of shareholders

Large variances in age and health among owners may complicate buy-sell arrangements. Healthy and/or young owners pay more to insure older and less healthy ones. This is particularly problematic in a cross purchase where the policies are owned by the shareholders individually.

#### Other issues

##### Dividend versus sales treatment

The general rule of corporate taxation is to treat shareholder distributions as dividends unless a specific exception can be found. In an entity redemption, the consequences of dividend versus sale treatment are important.

Is the redemption of decedent's shares a sale or a dividend?

- If the transaction is a dividend rather than a sale, the estate is taxed at ordinary income rates instead of the capital gains rate. This difference could be significant since stock held until death receives a step-up in basis to fair market value.

- An entity redemption can avoid dividend treatment if the estate has little or no ownership interest in the company after the sale.
- Ownership includes amounts attributed to the estate under Section 318 of the IRC.

In determining whether redemption qualifies as a sale, the deceased shareholder's estate will include stock in the redeeming corporation owned by family members and certain beneficiaries. Despite complete redemption of the deceased shareholders' stock, the transaction may still be characterized as a dividend because of indirect ownership under the attribution rules. If, on your client's death, family members or beneficiaries will continue owning the business, your client should consult an attorney to determine whether attribution poses a problem.

### Combining retirement with buy-sell arrangements

Cross-purchase and entity redemption buy-sell arrangements can cause income taxation if the client is trying to combine retirement planning with buy-sell planning.

### Entity redemption: Distribution of the policy to retiring insured

In entity redemption, the business owns life insurance policies on the owners. If the owners were to retire or dissolve the business, the distribution of life insurance policies with cash value to the owners will be a taxable event. The taxation will depend on the type of business entity:

<b>C corporations</b>	Any distributions of a life insurance policy from a C corporation will be taxable to the recipient either as a dividend or salary. The amount taxable is the fair market value under Notice 2005-25 (interpolated terminal reserve or the PERC amount). At the point of distribution, the corporation must recognize any gain to the extent that the cash value of the policy exceeds the corporation's premium payments. However, the corporation is entitled to a deduction under Section 162 to the amount the executive includes in income.
<b>S corporations</b>	If an S corporation distributes a policy to the insured shareholder as a K-1 distribution, any gain will be recognized to the corporation as if the property were sold at fair market value (generally, the difference between the policy's cost basis and its cash value without reduction for surrender charges), and any gain will pass through to the shareholder as ordinary income under the built-in gain rules.
<b>Partnerships</b>	Generally, distributions of property from a partnership to a partner are tax free under Section 731(a). Of course, if the distributions are considered compensation, then they are taxable income to the owner.

### Cross purchase: exchanging policies from owner to insured

In a cross purchase, the shareholders personally own policies on the lives of other shareholders. At retirement, if the shareholders were to transfer the policies to the insureds, each shareholder would recognize taxable gain (the difference between the price they paid for the asset they are trading and the value of the asset they are receiving).<sup>14</sup>

#### EXAMPLE

##### A owns a policy on B

\$5,000 premium for 10 years = \$50,000 cost basis and \$80,000 cash surrender value (CSV)

##### B owns a policy on A

\$5,000 premium for 10 years = \$50,000 cost basis and \$70,000 cash surrender value (CSV) Tax ramifications of uncrossing the policies

- Each has a cost basis of \$50,000
- A has \$20,000 taxable gain (\$70,000 CSV – \$50,000 cash basis)
- B has \$30,000 taxable gain (\$80,000 CSV – \$50,000 cash basis)

### Special considerations

<b>Tax treatment of premiums</b>	<b>Entity redemption:</b> The premiums paid by the corporation are nondeductible. <sup>15</sup> <b>Cross purchase and wait and see:</b> The premiums paid by each owner are nondeductible. <sup>16</sup> Since premiums are nondeductible in all arrangements, the form where the premium payer has the lowest tax bracket will result in the least cost. For example, if the C-corporation has a lower tax bracket an entity redemption arrangement may be appropriate.
<b>Surviving owners tax basis step-up</b>	<b>Entity redemption:</b> Although the value of the surviving owner's interest increases, his/her cost basis remains the same. This is because the corporation, rather than the survivor(s), purchases (redeems) the deceased owner's stock. <b>Cross purchase and wait and see:</b> Gives the surviving owners an increased cost basis for income tax purposes. <sup>17</sup> This occurs because the deceased owner's stock is being purchased directly by the surviving owners. This gives the surviving owners a basis equal to what they "paid" for the stock. A higher tax basis is only important if the surviving co-owner intends to sell his/her shares before he/she dies. With a "stepped-up" basis, a lifetime sale by the survivor will decrease any taxable gain. If the survivor holds the shares until death, however, the higher basis is no benefit since the basis is increased to fair market value. <sup>18</sup>

14. No transfer for value here because the policies are being transferred to the insureds. See section on transfer for value.

15. IRC §264.

16. IRC §262.

17. IRC §1012.

18. IRC §1014.

<b>Ownership allocation after a death</b>	<p><b>Entity redemption:</b> Surviving co-owner's ownership percentage will always increase pro rata.</p> <p><b>Cross purchase and wait and see:</b> Can change the new ownership percentage by specifying the number of shares each party wishes to purchase.</p> <p>If the survivors want to change their percentage of ownership, a cross-purchase arrangement should be used.</p>
<b>Elimination of earnings and profits</b>	<p>The undistributed earnings and profits of a corporation usually require dividend treatment to co-owners when the funds are distributed. However, when a corporation redeems all the shares of an owner, that owner's pro rata share of earnings and profit is also reduced by the amount of the distribution. This allows undistributed earnings and profits to be reduced without the recognition of ordinary income by the owner. An entity redemption or wait-and-see arrangement can take advantage of this reduction in the earnings and profit whereas a cross purchase cannot.</p>
<b>Effect of life insurance funding on the accumulated earnings tax</b>	<p>Life insurance owned by a company will be included in the date of death value of the company. An unreasonable accumulation of earnings question arises when funds (including insurance policy cash values) are being accumulated for an entity redemption agreement. Since premium payments for entity redemption insurance do not reduce taxable income, they will be subject to the accumulated earnings tax unless the accumulation meets the reasonable needs of the business.<sup>19</sup> Essentially, the issue is whether the redemption and associated life insurance cash value accumulation is for a "corporate" as opposed to an "owner" (dividend avoidance) purpose.</p> <p>Most of the cases focus on the selling owner control of the corporation. Where an owner owns 50 percent or less of the corporation's voting stock, most cases have held that the redemption is for a corporate need. Therefore, the insurance cash values were being accumulated for a reasonable business purpose. The reason most often cited by courts in support of reasonable business purpose is the need for business harmony. Smooth continuity of corporate management is essential to the long-term success of a business. Most cases found the need for business harmony only where the selling owner owned 50 percent or less of the stock.<sup>20</sup></p>

There are a couple rules of thumb in structuring buy-sell arrangements, especially when life insurance is the funding vehicle. These rules provide guidance in commonly encountered situations.

### Family corporations – problems with entity redemption

In almost any family-owned corporation, using an entity redemption arrangement may result in dividend treatment rather than capital gain due to the attribution rules. This means the entire amount received by the decedent's estate would be taxed as ordinary income, rather than capital gain. Since assets receive a step-up in basis upon the death of the owner, there would be little or no capital gain at the death of the owner. As a result, dividend treatment should be avoided when redeeming a deceased owner's shares.

19. IRC §§535, 537.

20. For a detailed discussion of the relevant issues, see Pelton, 28 T.C. 153 (1957) (80 percent owner redemption not for business purpose); Mountain State Steel, 50 T.C. 317 (1968) (entity redemption found to be effective means of solving problems between two 50 percent owners); Emeloid, 189 F.2d 230 (3rd Cir. 1951) (business harmony is the essential catalyst for achieving good management); and Ted Bates, 24 T.C.M. 1346 (1965) (the 72 percent owner's partial redemption designed to retain key employees and management expertise was for a business purpose).

As a general rule, distributions to owners are always dividends to the extent a corporation has accumulated current “earnings and profits.”<sup>21</sup> There are three exceptions to this rule.<sup>22</sup> A distribution will be treated as an “exchange” if:

1. It is not essentially equivalent to a dividend; or
2. It is substantially disproportionate with respect to the owner; or
3. It is a complete redemption of all stock owned by the owner.

Although each exception can be quite complicated, an owner in a buy-sell situation should be able to meet one of them.

### **Family attribution**

Although the “complete redemption” exception provides relief in most cases, the attribution rules can cause problems for the family corporation. Under the family attribution rules, an individual is considered to own all of the stock owned by his/her spouse, parents, children and grandchildren (but not siblings).<sup>23</sup>

In addition, property transferred to a trust, estate, partnership or corporation could be “attributed” to the family members.<sup>24</sup> Thus, under a typical scenario where a parent’s stock is completely redeemed, the children’s stock will be attributed back to the parent. The result: the “complete redemption” exception is not met, and the redemption may be considered a dividend.

There are two ways to avoid the family attribution rules in an entity redemption situation:

1. Make an outright bequest of the business interest; or
2. Elect to waive the family attribution rules.

### **Bequest**

The objective in both cases is to pass the business from parent to child. With an entity redemption, this is accomplished by gifting a small amount of stock to the child. Then, when the parent dies, all of the parent’s stock is redeemed leaving the child as sole owner. However, using this arrangement may invoke the family attribution rules. To avoid this problem the parent can bequest the business interest to the child.

The simple bequest has many advantages. The same amount of insurance intended to redeem the stock can instead be used for other estate planning needs. For example, it can provide an inheritance to children not involved in the business, since most parents commonly desire to treat all their children equally. The life insurance proceeds could also be used to provide lifetime income for a surviving spouse or provide estate liquidity. The bequest arrangement is simple, involves no agreement and has the added attraction of keeping the insurance out of the estate (by use of an irrevocable trust) if desired.

21. IRC §316(a).

22. IRC §302(b).

23. IRC §318(a)(1).

24. IRC §318(a)(2) & (3).

### **Waiver of family attribution rules**

The second way to avoid dividend treatment is where the family member elects to “waive” the attribution rules.<sup>25</sup> Under this provision, the redemption will qualify as an exchange if the following conditions are met:

- The co-owner terminates all his/her interest in the corporation, including any interest as officer, director or employee.
- He/she does not acquire any interest in the corporation during the 10 years following the redemption.
- He/she does not, during the 10 years preceding the redemption, acquire any of the stock redeemed from any person whose ownership would be attributed to him/her under the construction of ownership rules of Section 318, or transfer any stock to any such person who continues to hold stock after the redemption.

Although the waiver conditions can often be met, it applies only to the family attribution rule. The attribution rules of trust and estates must also be avoided, making estate planning for redemption of stock in a family corporation extremely difficult. For this reason, using a cross-purchase or wait and see arrangement, or the outright bequest as detailed above, is often suggested.

### **Valuation of business interest – does the buy-sell arrangement help?**

Unrelated co-owners of a closely held corporation may be able to “fix” the value of their stock through mandatory buy-sell arrangements. The price fixed in the restrictive agreement may serve as the value for federal estate tax purposes, if:

1. The co-owner and the estate are required to sell the shares.
2. The purchaser in the buy-sell is required to buy, or at least has the option to buy, at the price stated in the buy-sell arrangement.
3. The obligation to sell is binding on the decedent during his or her lifetime, as well as upon death.
4. The price in the buy-sell is either fixed according to a formula or there is an established method for fixing the formula inside the arrangement.
5. The agreement is negotiated as an arms-length business arrangement.<sup>26</sup>

If all of these conditions are met, the agreement will control for estate tax purposes despite later increases in the business value.

As is often the case in estate planning, family-owned corporations pose special problems. Members of a family-owned corporation may be motivated to set the value of the business at an artificially low price in order to avoid estate taxes. Thus, the value given to the business is often not at arm’s length. For this reason, buy-sell arrangements between family members must satisfy the above requirements and the requirements identified in Code Section 2703.

25. IRC §302(c)(2)(A).

26. See generally, IRC Regulation 20.2031, Rev. Rul. 59-60; *St. Louis County National Bank vs. U.S.* 674 F.2d 1207 (8th Cir. 1982).

**Code Section 2703 requires that:**

- The buy-sell arrangement must be a bona fide business arrangement.
- The agreement must not be a device to transfer property to members of the decedent's family for less than full and adequate consideration in money or money's worth.
- The terms of the agreement must be comparable to similar arrangements entered into by persons in an arms-length transaction.

**Code Section 2704(c) defines "member of the family" to mean:**

- An individual's spouse
- Any ancestor or lineal descendant of an individual or their spouse
- Any brother or sister of an individual
- Any spouse of anyone described above.



# Community property

## Special considerations with buy-sell planning

Clients in community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Washington and Wisconsin) require special consideration when implementing a buy-sell arrangement. Community property is a concept whereby each spouse shares an equal ownership interest in property held by the other spouse if it was obtained during their marriage while living in a community property state. Accordingly, one spouse cannot dispose of such property without the other's consent. Therefore, in a buy-sell arrangement, where any of the parties are or ever were married and living together in a community property state, the rules and concerns that follow should be observed.

### **Business interest held as community property**

Generally, business interests that constitute community property may be held or titled in the name of the spouse who is an owner of the business. However, this doesn't divest the non-titled spouse of his or her community property rights in the business. Accordingly, in a buy-sell arrangement where any of the parties are (or ever were) residents of a community property state, the agreement should contain written consent of both spouses to the terms of the agreement. Namely, it should provide:

- A provision invalidating any attempted testamentary transfer of either spouse's interest in the business or the life insurance policies funding the agreement to someone other than the surviving spouse in the event one predeceases the other and giving the survivor a right of first refusal on such property; and
- Wording dealing with the disposition of the stock and the life insurance policies funding the agreement in the event the couple becomes divorced or separated and requiring a mandatory offer of the property to the corporation or the shareholders before it can fall entirely into the hands of the spouse who did not work in the business

In the absence of such measures, the non-titled spouse is free to dispose of his or her business interests in a manner that may be inconsistent with the terms of the buy-sell arrangement. The intentions of the titled spouse and his or her owners may be permanently crippled.

### **Life insurance policies held as community property**

The non-titled spouse's community property interest in life insurance policies owned by the titled spouse to fund a cross-purchase buy-sell is an equally important concern. If the non-titled spouse were to assert his or her interest in the death proceeds, the titled spouse will only be left with half the amount needed to buy out a deceased owner. The suggestions of making the policies part of the buy-sell with the non-titled spouse as signatory to the agreement can be a solution. In addition, the titled spouse may arrange to pay the premiums with separate property to preserve the policies and their death proceeds as separate property. In a redemption strategy, community property ownership of the policies is not an issue. This is because spouses own a community property interest in the business interests and not in the individual assets held by the business.

# Forms of buy-sell structuring: examples and specimen documents

1. Cross purchase
2. Entity redemption
3. Wait and see
4. One way

## Cross-purchase buy-sell

### What is a cross- purchase buy-sell?

A cross-purchase buy-sell is an arrangement where each business owner is the owner and beneficiary of a policy on each of the other business owners. Upon the death of a business owner, each of the remaining business owners uses the death benefit from the life insurance policy on the decedent to purchase a proportionate share of the decedent's ownership.

Each owner pays premiums and uses the insurance proceeds to purchase the ownership from the deceased owner's estate. After the purchase of the ownership, the other owner's interests are increased by the amount of ownership purchased.

<b>Agreement between</b>	Business owners
<b>Number of policies</b>	$N \times (N-1)$
<b>Owner and beneficiary</b>	Purchasing business owner
<b>Taxation of policy premiums</b>	Premiums are not deductible.
<b>Business: Deduction for bonus*</b>	Only if business is a C corporation
<b>Owner: Bonus taxed as income</b>	Tax-free
<b>Taxation of death benefit proceeds</b>	Only if business is a C corporation
<b>Increased basis for surviving owners</b>	Tax-free
<b>Allocation of ownership after death of owner</b>	Yes
<b>Premium cost allocation</b>	Deceased owner's interest allocated as desired (must be determined prior to death)
<b>Living buyout/retirement funding</b>	Cost is higher for older and rated owners
<b>Use of existing policies</b>	Transfer of policy to insured triggers taxation of earnings portion of cash value  Transferring a policy (owned by one owner on the life of another) to a co-owner is subject to transfer for value rules

\*Life insurance premiums are a non-deductible expense per IRC Section 264. Wages, salary and bonuses are deductible to a company and taxed as income to the insured or policy owner.

## Benefits

- Basis increase for the surviving owners
- Can reallocate the owners' interests at buyout
- Assets safe from business creditors

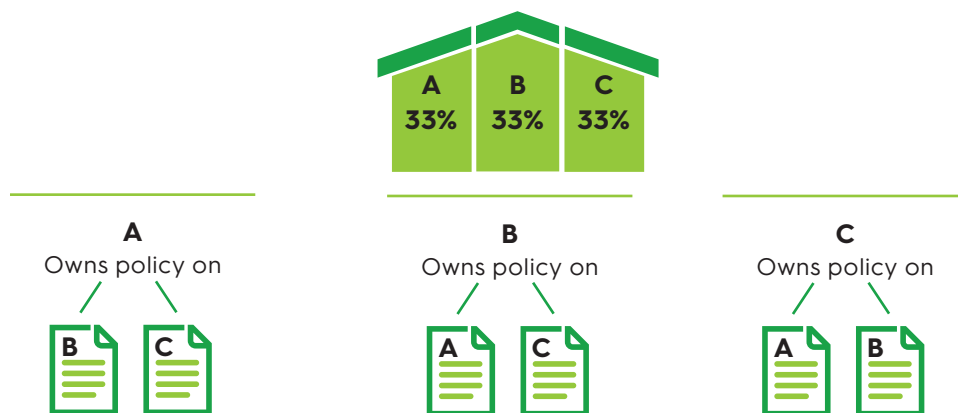
## Considerations

- Difficult to use insurance proceeds for personal retirement
- Requires multiple policies on each owner
- Not safe from personal creditors

## Structure

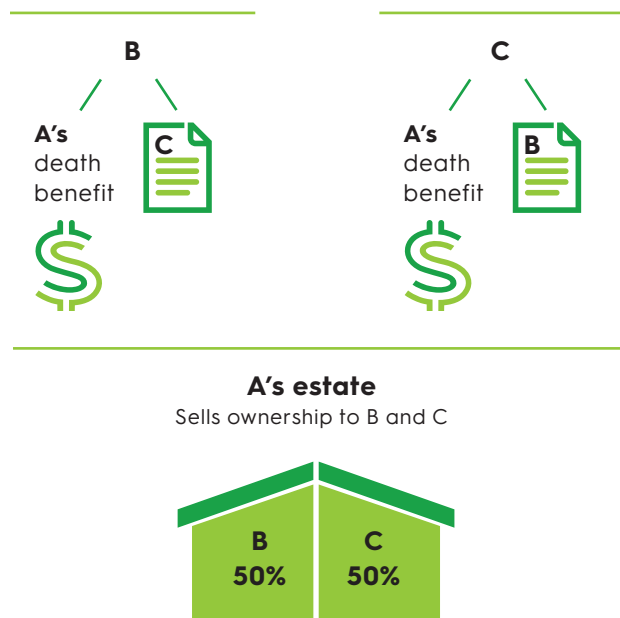
### Set up

A, B and C are equal owners of a business. They enter into an arrangement providing that on the death of an owner, the surviving owner(s) will buy the deceased owner's ownership. Each business owner buys a life insurance policy on the other owners' lives and names himself (or herself) as beneficiary.



### Upon A's death

Upon A's death, B and C receive tax-free life insurance proceeds from their policies on A. Then, B and C use the insurance proceeds to buy A's ownership from A's estate. A's heirs receive cash, and B and C end up with A's business interest.



### Upon B's death

At B's death, C receives tax-free life insurance proceeds from the policy on B. Then, C uses the insurance proceeds to buy B's ownership from B's estate. B's heirs receive cash, and C receives the complete ownership of the business.



# Preface to cross-purchase agreement

This specimen cross-purchase agreement is an example of how counsel might draft such a document. This specimen should be used only as a guide. It outlines basic provisions usually included in such agreements. This specimen agreement is not intended as a final draft.

Counsel should revise it as necessary to meet the clients' needs. **Counsel alone is responsible for the actual wording of the final cross-purchase agreement.** Neither Securian Financial nor its representatives are engaged in the practice of law; these specimen agreements are intended for illustrative purposes and counsel must draft a cross-purchase agreement appropriate for his or her client.

## Specimen cross-purchase agreement

This agreement is entered into on the day of [DATE], by and between [NAME], of [ADDRESS], and [NAME], of [ADDRESS], hereinafter called "stockholders."

The stockholders own stock in [NAME OF CORPORATION], hereinafter called the "corporation" in the amounts set forth in attached Schedule A. Each stockholder wishes to make all of their stock subject to the terms of this agreement.

The stockholders desire to ensure the continuity of management of the corporation by providing for the purchase of a stockholder's stock in the event of death or in the event of a sale of any shares during the stockholder's lifetime. In consideration of the promises in this agreement, the stockholders bind themselves as follows:

### Article 1: Sale of stock during lifetime

If a stockholder desires to sell part or all of his/her shares of stock at any time during his/her lifetime, he/she shall first give written notice to the other stockholders, who, upon receipt of the notice, shall have days to purchase such shares of stock at the price established in accordance with Article 3. If said shares of stock are not purchased within the period, the stockholder desiring to sell the shares may dispose of them in any lawful manner available, but not at a price less than that established in accordance with Article 3, without first offering to sell the shares to the other stockholders at the lesser price.

### Article 2: Sale of stock upon death

Upon the death of a stockholder, the surviving stockholder(s) shall purchase, and the estate of the decedent (and the decedent's spouse) shall sell, the shares of the stock now owned or later acquired (including any interest now owned or later acquired from the decedent's estate through applicable community property laws). The sale price shall be determined in accordance with Article 3, upon the conditions set forth in Article 4.

### **Article 3: Value of stock**

The value of the stock, as determined by the stockholders, is \$[PRICE] per share. At the end of each fiscal year, or within [DAYS] days thereafter, the stockholders shall redetermine the value of the stock. The new stock value shall be attached to this agreement on Schedule B and shall be signed by and binding on all the parties to this agreement.

If a stockholder dies within twelve (12) months of the last stock price redetermination, that price shall be used. If more than twelve (12) months have passed since the last redetermination, however, then qualified appraisers shall be appointed to determine the value, as follows:

The surviving stockholder(s) shall have the opportunity to appoint, at their own cost, a qualified appraiser, within [DAYS] days of appointment of a legal representative to the decedent's estate. The legal representative of the deceased stockholder may do the same. If only one party appoints a qualified appraiser within the [DAYS] days, that appraiser shall unilaterally establish the value for the shares of stock by a written opinion.

If more than one party appoints a qualified appraiser within the [DAYS] days, those appraisers shall establish a value in a single written opinion agreed to by them. If they cannot agree, they shall together appoint a qualified appraiser whose sole written opinion shall establish the appraised value.

For purposes of this section, a "qualified appraiser" is a professional appraiser or Certified Public Accountant who is qualified by experience and ability to appraise such shares of stock. The appointment of a qualified appraiser shall be made by notifying the other party in writing of the appointment.

Notwithstanding the above procedure, the legal representative and the surviving stockholder(s) may accept as controlling the last valuation made. It is the intent of the parties that the value of the stockholder's interest as determined does include goodwill.

### **Article 4: Purchase of decedent's stock**

Upon the death of a stockholder, the surviving stockholder(s) shall, within [DAYS] days after the appointment of a legal representative of the decedent's estate, proceed to purchase all of the decedent's stock in the corporation for the value determined in Article 3. Each surviving stockholder shall purchase a proportionate amount of the stock as follows:

For each surviving stockholder, multiply the total shares owned by the deceased stockholder at the time of death by a fraction; the numerator is the number of shares owned by each surviving stockholder at the death of the deceased stockholder, and the denominator is the number of shares owned by all of the surviving stockholders at the time of death of the deceased stockholder.

The surviving stockholders shall immediately collect the proceeds of the policies owned by him/her on the life of the deceased stockholder for purposes of this agreement and apply as much of the proceeds as necessary to purchase the shares of the deceased stockholder.

If the life insurance proceeds are insufficient, the surviving stockholders may pay the balance either in one sum or by executing and delivering a negotiable promissory note. Such note shall be payable in [NUMBER] equal (monthly, annual) installments, the first of which shall be payable to the decedent's legal representative, or a designated party, [NUMBER] months after the death of the stockholder, together with interest at the rate of [PERCENTAGE] percent per year on the unpaid balance. Such note shall provide that the unpaid balance becomes payable immediately upon default.

Missing an installment payment by more than [DAYS] days will be considered a default. The purchasers shall have the right to pay off any and all installments prior to the actual due date without penalty.

Upon receipt of the entire purchase price in cash and/or note, as provided in this agreement, the legal representative shall transfer the decedent's stock to the surviving stockholder(s).

The surviving stockholder(s) shall pledge all of the decedent's stock acquired as security for the unpaid balance of any note but may exercise all rights of ownership in the stock prior to a default.

#### **Article 5: Insurance policies**

In order to provide liquidity to purchase the shares of the deceased stockholder, the stockholders have purchased insurance on the lives of each other. Any insurance policy owned by the company will be included in the value of the company at the date of death of any stockholder. The details of the insurance are set forth in Schedule C attached.

Each stockholder may purchase additional insurance on the lives of any of the other parties to this agreement, or anyone who may later become a party to this agreement. Additional purchases of insurance shall also be listed on Schedule C.

Each stockholder shall be the beneficiary and absolute owner of all policies purchased by him/her on the life of the other stockholder(s) for purposes of this agreement. Each stockholder shall retain physical custody of the policies and pay all premiums necessary to keep the policies in force. Until termination of this agreement, no stockholder shall do any of the following to the policies: take a withdrawal from the policy, borrow upon the policies, receive cash dividends, or pledge or assign the policies as security for any loan or indebtedness. Nor shall any stockholder otherwise modify or impair any of the rights or values of the policies, except with written consent of the insured stockholder(s).

**Article 6: Purchase of policy by insured**

Upon the death of a stockholder, each surviving stockholder shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on his/her life that the decedent purchased because of this agreement. In the event a stockholder sells all his/her stock during his/ her lifetime, he/she shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on his/her life under this agreement. Likewise, each of the other stockholders shall have the right to purchase, during the same time, all contracts of insurance on their lives under this agreement owned by the selling stockholder. Upon termination of this agreement for any reason, each stockholder shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on their lives owned by other stockholders because of this agreement.

The purchase price for each policy under this Article shall be the net cash value plus any unearned premium. The net cash value equals the policy's cash value less indebtedness. If the right to purchase the policy is not exercised, the policy owner may hold or dispose of the policy at his/her discretion.

**Article 7: Endorsement of stock certificates**

The stock certificates for all stock of the corporation subject to this agreement shall be endorsed as follows: "The sale or transfer of this certificate is subject to a Buy-Sell Agreement dated [DAY] [MONTH], [YEAR]."

**Article 8: Amendment and termination**

This agreement may be amended or terminated by a written agreement signed by all parties. This agreement shall be terminated by the bankruptcy, receivership or dissolution of the corporation.

**Article 9: Liability of insurance company**

Any insurance company issuing policies of insurance pursuant to this agreement shall have no liability except as set forth in the policy. The payment by an insurance company pursuant to the terms of any policies, which are subject to this agreement, shall be a complete discharge of the company from all claims, suits and liability.

**Article 10: Choice of law**

This agreement shall be construed in accordance with the laws of the State of [STATE].

**Article 11: Heirs, executors and administrators**

This agreement shall be binding upon the stockholders individually and their respective heirs, executors and administrators.



#### **Article 12: Disposition by spouse (optional, community property)**

In the event that the spouse of a stockholder predeceases him or her and makes a testamentary disposition of his or her community interest in the stock, then:

**Transfer to surviving spouse:** To the extent that such disposition is to his or her surviving spouse, or to a trust or trusts of which he or she is sole trustee, the transfer shall not be subject to the offer requirements under this agreement, but the interests of transfer shall, in the hands of the transferee, be subject to this agreement fully as if still owned by the stockholder. This includes, but is not limited to, the duty of the transferee to sell such interests to the other stockholders, and their duty to purchase it, on the stockholder's death.

**Transfer to others:** Except as provided above, no such disposition by such spouse shall be effective without him or her first offering such interest as follows: To his or her surviving spouse, the entirety thereof on the same terms and at the same proportionate price as applies to a transfer by a stockholder during his or her lifetime under Article 1, but without any prior offer to the corporation or to the other stockholders.

If his or her surviving spouse fails to accept such offer, then to the other stockholders, the entirety thereof on the same terms and for the same proportionate price as applies to a transfer by stockholder during his or her lifetime under Article 1, but without any prior offer to the corporation.

#### **Article 13: Acknowledgment (optional, community property)**

Each stockholder and his or her spouse declares that he or she, respectively, is completely informed as to the facts relating to the subject matter of this agreement and as to their rights and liabilities; enters into this agreement voluntarily after receiving advice (or after having had the opportunity to receive advice) of independent counsel of his or her own choosing; has given mature thought to making this agreement; has carefully read each provision of this agreement; and fully and completely understands each provision of this agreement, both as to subject matter and legal effect.

(Formalities of execution are governed by local law.)

The parties have executed this agreement at [CITY], in the County of [COUNTY], State of [STATE], on this [DAY] day of [MONTH], [YEAR].

---

Stockholder

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Stockholder

**Consent of spouses**

We, the undersigned spouses of the stockholders, hereby acknowledge that we have read the foregoing agreement and consent to its terms, to the disposition made therein of any interest we have in the stock of the corporation or the life insurance policies described under Schedule C as community or separate property, and to the price now or hereafter determined by the stockholders.

\_\_\_\_\_  
Spouse

\_\_\_\_\_  
Spouse

**Schedule A**

The amount of stock in the corporation owned by each stockholder is as follows:

Stockholder      Number of shares

- 1.
- 2.
- 3.
- 4.
- 5.

**Schedule B**

This [DAY] day of [MONTH], [YEAR], the stockholders have determined the value of the stock of the corporation for purposes of this agreement to be \$[PRICE] per share.

\_\_\_\_\_  
Stockholder

\_\_\_\_\_  
Stockholder

**Schedule C**

Name	Policy number	Insurance company	Face amount

# Entity redemption buy-sell

## What is an entity redemption buy-sell?

An entity redemption buy-sell is made between a business and each of the business owners. Each business owner agrees to sell his or her interest to the business at death. The business agrees to buy the owner's interest.

The business:

- Owns insurance on each business owner's life
- Pays the premiums
  - Is the beneficiary of each policy
  - Upon the death of one business owner, the business collects the insurance proceeds and uses them to purchase the deceased business owner's stock. The death proceeds of the insurance will be included in the value of the business for estate tax purposes. After the redemption of the ownership, the other owners' interest is increased proportionately.

<b>Agreement between</b>	Business and owners
<b>Number of policies</b>	One per owner
<b>Owner and beneficiary</b>	Business
<b>Taxation of policy premiums</b>	Nondeductible
<b>Taxation of death benefit proceeds</b>	Tax-free (notice and consent). Policy death proceeds included in value of business
<b>Increased basis for surviving owners</b>	No (unless partnership or S corporation (cash accounting))
<b>Allocation of ownership after death of owner</b>	Surviving owner's interest increases on pro rata basis
<b>Premium cost allocation</b>	Cost of insurance is spread among owners
<b>Living buyout/Retirement funding</b>	Surviving owner's interest increases on pro rata basis
<b>Use of existing policies</b>	Surviving owner's interest increases on pro rata basis

## Benefits

- Requires only one policy per owner
- Premium payments equalized among owners
- Owners control funding vehicle as a group
- Not subject to personal creditors

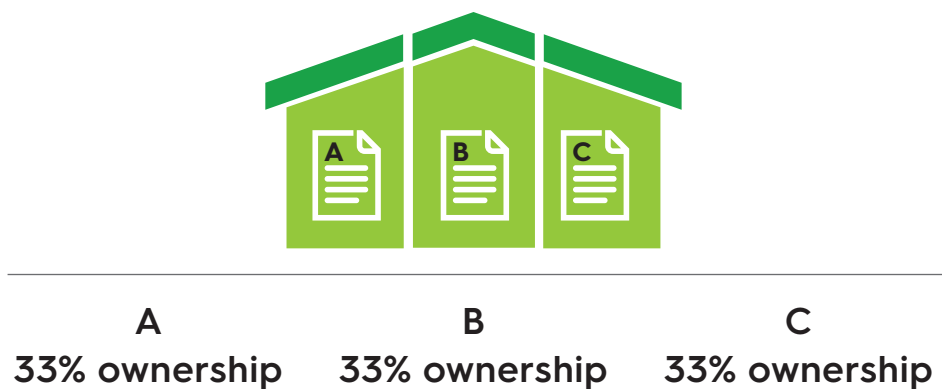
## Considerations

- Does not increase basis for surviving owners
- Subject to corporate creditors
- Owner retirement benefits are taxable
- Insurance death proceeds included in the date of death value of the business

**Structure**

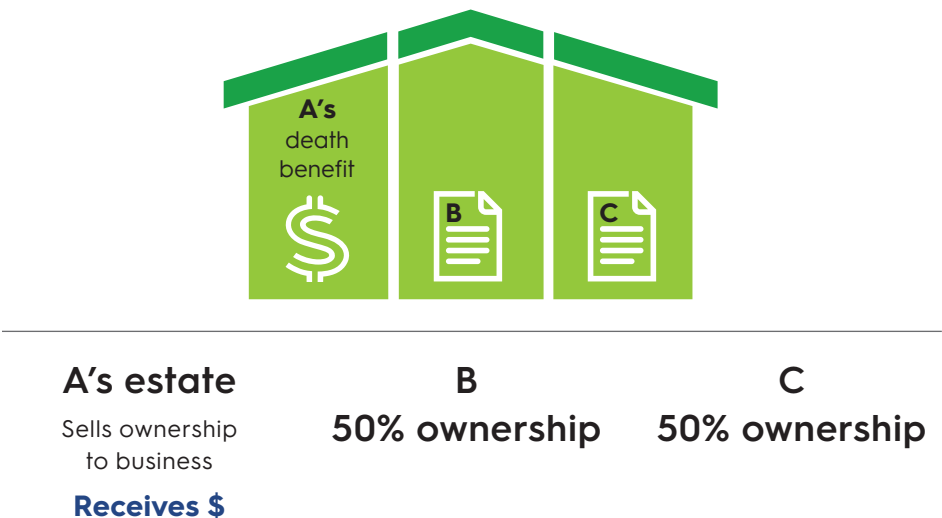
**Set up**

A, B and C are equal owners of a business. They enter into an arrangement with the business providing that the business will purchase the ownership – at a set price – of any owner who dies. The business purchases the life insurance on all three owners. The life insurance will be included in the date of death value of the business and generally increases the value of the business for estate tax purposes.



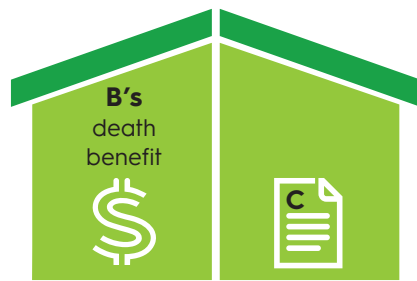
**Upon A's death**

At A's death, the business entity receives the death benefit. The business entity uses the death benefit to purchase as much of the ownership of the deceased owner as it can afford. B and C own all of the outstanding ownership interests. B and C may also have to take a promissory note for the difference between the share values and what the insurance covers.



### Upon B's death

At B's death, the business receives the death benefit and then uses it to purchase the ownership of the deceased owner. C then owns all of the outstanding ownership interests.



---

#### B's estate

Sells ownership  
to business

**Receives \$**

**C**

**100% ownership**

There is no clear-cut way to calculate the amount of insurance necessary to fully fund a stock redemption agreement where life insurance contracts are part of the business valuation. Post *Connelly v. US*, the business is valued including the insurance. So, in our example if the business is worth \$3,000,000 and there is life insurance on the lives of A, B and C of \$1,000,000 apiece, If A dies first, the business is worth \$4,000,000 (\$3,000,000 plus the \$1,000,000 death benefit). A's 1/3 share of \$4,000,000 is \$1,333,333.33. The policy that the business has is only \$1,000,000 of death benefit. B and C must come up with the other \$333,333.33 either out of pocket, from future earnings or a promissory note for the difference payable to the estate of A. A, B and C could each purchase a \$333,333 policy on the other to "square u" the date of death conundrum. Thus, entity purchases post *Connelly* may have to include some form of "employer financing" or the surviving shareholders may have to use outside funds to complete the buy-sell transaction.

# Preface to entity redemption specimen agreement

This specimen agreement is an example of how counsel might draft such a document. This specimen should be used only as a guide. It outlines basic provisions usually included in such agreements. This specimen agreement is not intended as a final draft.

Counsel should revise it as necessary to meet the clients' needs. **Counsel alone is responsible for the actual wording of the final agreement.** Neither Securian Financial nor its representatives are engaged in the practice of law; these specimen agreements are intended for illustrative purposes and counsel must draft an entity redemption agreement appropriate for his or her client.

## Specimen resolution authorizing entity redemption agreement

I, [NAME OF SECRETARY] Secretary of [NAME OF CORPORATION], a corporation duly organized and existing under and by virtue of the laws of the State of [STATE], DO HEREBY CERTIFY:

That on the [DAY] day of [MONTH], [YEAR], a meeting of the Board of Directors of the Corporation was held at [ADDRESS], at which a quorum was present, and the following resolution was unanimously adopted by the Board of Directors:

The Corporation desires to provide for harmonious and successful management of the Corporation and wishes to provide for the successful continuation of the Corporation beyond the death of a stockholder; and the Corporation wishes to protect itself against the financial expenses which would arise on the death of a stockholder.

THEREFORE, IT IS RESOLVED:

That an Entity Redemption Agreement, a copy of which is attached to and made a part of this Resolution, is approved and the [TITLE OF APPROPRIATE OFFICER] is expressly authorized and directed to execute the agreement on the Corporation's behalf;

FURTHER, IT IS HEREBY RESOLVED:

That in order to fund its obligations under the agreement, and to insure itself against the financial expenses which would arise on the death of a stockholder, the Corporation approves and ratifies the purchase of the following insurance policies: [AMOUNT & TYPE OF CONTRACT] on the life of [INSURED]; [AMOUNT & TYPE OF CONTRACT] on the life of [INSURED];

*(Formalities of execution are governed by local law.)*

WITNESSING THE ADOPTION OF THIS RESOLUTION, I have signed and stamped the seal of the Corporation hereunder in the City of [CITY], State of [STATE], on this [DAY] day of [MONTH], [YEAR].

---

Signature of Secretary

---

Name

# Specimen entity redemption agreement

This agreement is entered into on the [DAY] day of [MONTH], [YEAR], by and between [NAME], of [ADDRESS], and [NAME], of [ADDRESS], hereinafter called "stockholders" and [CORPORATION NAME], a Corporation with its principal office located at [CORPORATE ADDRESS], hereinafter called the "Corporation."

The stockholders own stock in the Corporation in the amounts set forth in attached Schedule A. Each stockholder wishes to make all of their stock subject to the terms of this agreement.

The stockholders desire to ensure the continuity of management of the Corporation by providing for the purchase of a stockholder's stock by the Corporation in the event a stockholder dies or desires to sell any of his/her shares during his/her lifetime. In consideration of the promises in this agreement, the parties bind themselves as follows:

## **Article 1: Sale of stock upon death**

Upon the death of a stockholder, the Corporation shall purchase, and the estate of the decedent [and the decedent's spouse] shall sell, the shares of the stock now owned or later acquired by the stockholder [including any interest now owned or later acquired by the decedent's spouse through applicable community property laws]. The sale price shall be determined in accordance with Article 3, upon the conditions set forth in Article 4.

## **Article 2: Sale of stock during lifetime**

If a stockholder(s) desires to sell part or all of his/her shares of stock at any time during his or her lifetime, he/she shall first give written notice to the Corporation, which upon receipt of the notice, shall have [DAYS] days to purchase such shares of stock at the price established in accordance with Article 3. If said shares of stock are not purchased within the stated period, the stockholder desiring to sell the shares may dispose of them in any lawful manner available, but not at a price less than that established in accordance with Article 3, without first offering to sell the shares to the corporation at such a lesser price.

## **Article 3: Value of stock**

The value of the stock, as determined by the Corporation and the stockholders, is \$[PRICE] per share. At the end of each fiscal year, or within [DAYS] days thereafter, the Corporation and the stockholders shall redetermine the value of the stock. The new stock value shall be attached to this agreement on Schedule B and shall be signed by and binding on all the parties to this agreement. Any such value of the stock shall include any death proceeds receivable by the corporation on the death of a shareholder.

If a stockholder dies within twelve (12) months of the last stock price redetermination, that price shall be used. If more than twelve (12) months have passed since the last redetermination, then qualified appraisers shall be appointed to determine the value, as follows:

The Corporation shall have the opportunity to appoint, at its own cost, a qualified appraiser, within [DAYS] days of appointment of a legal representative to the decedent's estate. The legal representative of the deceased stockholder may do the same. If only one party appoints a qualified appraiser within the [DAYS] days, that appraiser shall unilaterally establish the value for the shares of stock by a written opinion.

If both parties appoint a qualified appraiser within the [DAYS] days, those appraisers shall establish a value in a single written opinion agreed to by them. If they cannot agree, they shall together appoint a qualified appraiser whose sole written opinion shall establish the appraised value.

For purposes of this section, a “qualified appraiser” is a professional appraiser or Certified Public Accountant who is qualified by experience and ability to appraise such shares of stock. The appointment of a qualified appraiser shall be made by a written instrument delivered to the other party.

Notwithstanding the above procedure, the legal representative and the Corporation may accept as controlling the last valuation made. It is the intent of the parties that the value of a stockholder’s interest as determined does include goodwill.

#### **Article 4: Purchase of decedent’s stock**

Upon the death of a stockholder, the Corporation shall, within [DAYS] days after the appointment of a legal representative of the decedent’s estate, proceed to purchase all of the decedent’s stock in the Corporation, for the value determined in Article 3. The Corporation shall immediately collect the proceeds of the policies on the life of the deceased stockholder for purposes of this agreement and apply as much of the proceeds as necessary to purchase the shares of the deceased stockholder.

If the life insurance proceeds are insufficient, the Corporation may pay the balance either in one sum or by executing and delivering a negotiable promissory note. Such note shall be payable in [NUMBER] equal (monthly, annual) installments, the first of which shall be payable to the decedent’s legal representative, or a designated party, [MONTHS] months after the death of a stockholder, together with interest at the rate of [PERCENTAGE] percent per year on the unpaid balance. Such note shall provide that the unpaid balance becomes payable immediately upon default. Missing an installment payment by more than [DAYS] days will be considered a default. The Corporation shall have the right to pay off any and all installments prior to the actual due date without penalty.

Upon receipt of the entire purchase price in cash and/or note, as provided in this agreement, the legal representative shall transfer the decedent’s stock to the Corporation. The Corporation shall pledge all of the decedent’s stock acquired as security for the unpaid balance of any note but may exercise all rights of ownership in the stock prior to a default.

#### **Article 5: Insurance policies**

In order to assure funds are available to purchase the shares of the deceased stockholder, the Corporation has purchased insurance on the lives of each stockholder. Any life insurance policy owned by the company will be included in the value of the company at the date of death of any stockholder. The details of the insurance are set forth in Schedule C attached.

The Corporation may purchase additional insurance on the stockholder(s) to further the availability of funds for this redemption. Any changes or additional purchases of insurance shall also be listed on Schedule C.



The Corporation shall be the beneficiary and absolute owner of all policies purchased by it on the life of the stockholder(s) for purposes of this agreement. The Corporation shall retain physical custody of the policies and pay all premiums necessary to keep the policies in force. Until termination of this agreement, the Corporation shall not do any of the following to any policies purchased pursuant to this agreement: surrender the policies for the cash value, borrow upon the policies, receive cash dividends, pledge or assign them as security for any loan or indebtedness, nor shall it otherwise modify or impair any of the rights or values of the policies, except with written consent of the insured stockholder(s).

#### **Article 6: Purchase of policy by insured**

In the event a stockholder sells all his/her stock during his/her lifetime, he/she shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on his/ her life under this agreement. Upon termination of this agreement for any reason, each stockholder shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on their lives owned by the Corporation because of this agreement.

The purchase price for each policy under this Article shall be the net cash value plus any unearned premium. The net cash value equals the policy's cash value less indebtedness. If the right to purchase the policy is not exercised, the Corporation may hold or dispose of the policy at its own discretion.

#### **Article 7: Endorsement of stock certificates**

The stock certificates for all stock of the corporation subject to this agreement shall be endorsed as follows: "The sale or transfer of this certificate is subject to an Entity Redemption Agreement dated [DAY] [MONTH], [YEAR]."

#### **Article 8: Amendment and termination**

This agreement may be amended or terminated by a written agreement signed by all parties. This agreement shall be terminated by the bankruptcy, receivership or dissolution of the corporation.

#### **Article 9: Liability of insurance company**

Any insurance company issuing policies of insurance pursuant to this agreement shall have no liability except as set forth in the policy. The payment by an insurance company pursuant to the terms of any policies which are subject to this agreement shall be a complete discharge of the company from all claims, suits and liability.

#### **Article 10: Choice of law**

This agreement shall be construed in accordance with the laws of the State of [STATE].

#### **Article 11: Heirs, executors and administrators**

This agreement shall be binding upon the stockholders individually and their respective heirs, executors and administrators.

#### **Article 12: Effect of entity redemption restrictions**

If the Company is unable to make any purchase required under this agreement due to applicable statutes or its charter or bylaws, the Company shall take any action necessary to permit it to make the purchases. The stockholders to this agreement also shall take any necessary action to allow the Company to make the purchases.

#### **Article 13: Disposition by spouse (optional, community property)**

In the event that the spouse of a stockholder predeceases him or her and makes a testamentary disposition of his or her community or separate interests in the stock, then:

**Transfer to surviving spouse.** To the extent that such disposition is to his or her spouse, or to a trust or trusts to which he or she is the sole trustee, the transfer shall not be subject to the offer requirements under this agreement, but the interests so transferred shall, in the hands of the transferee, be subject to this agreement fully as if still owned by the stockholder. This includes, but is not limited to, the duty of the transferee to sell such stock to the corporation and the corporation's duty to purchase it, on the stockholder's death.

**Transfer to others.** Except as provided above, no such disposition by such spouse shall be effective without his or her first offering such interests as follows: To his or her surviving spouse, the entirety thereof on the same terms and for the same proportionate price as applies to a transfer by a stockholder during his or her lifetime under Article 2.

If his or her surviving spouse fails to accept such offer, then to the other stockholders, the entirety thereof on the same terms and for the same proportionate price as applies to a transfer by a stockholder during his or her lifetime under Article 2. In such event each other stockholder shall be entitled to purchase the number of shares which bears the same ratio to the number offered as his or her shares bear to the total shares held by all other stockholders.

#### **Article 14: Acknowledgment (optional, community property)**

Each stockholder and his or her spouse declares that he or she, respectively, is completely informed as to the facts relating to the subject matter of this agreement and as to their rights and liabilities; enters into this agreement voluntarily after receiving advice (or after having had the opportunity to receive advice) of independent counsel of his or her own choosing; has given mature thought to making this agreement; has carefully read each provision of this agreement; and fully and completely understands each provision of this agreement, both as to subject matter and legal effect.

*(Formalities of execution are governed by local law.)*

The parties have executed this agreement at [ADDRESS], in the County of [COUNTY], State of [STATE], on this [DAY] day of [MONTH], [YEAR].

---

Stockholder

---

Stockholder

**Consent of spouses**

We, the undersigned spouses of the stockholders, hereby acknowledge that we have read the foregoing agreement and consent to its terms, to the disposition made therein of any interest we have in the stock of the corporation or the life insurance policies described under Schedule C as community or separate property, and to the price now or hereafter determined by the stockholders.

\_\_\_\_\_  
Spouse

\_\_\_\_\_  
Spouse

**Schedule A**

The amount of stock in the corporation owned by each stockholder is as follows:

Stockholder	Number of shares
1.	
2.	
3.	
4.	
5.	

**Schedule B**

This [DAY] day of [MONTH], [YEAR], the stockholders have determined the value of the stock of the corporation for purposes of this agreement to be \$[PRICE] per share.

\_\_\_\_\_  
Stockholder

\_\_\_\_\_  
Stockholder

**Schedule C**

Name	Policy number	Insurance company	Face amount
_____			
_____			
_____			
_____			

# Wait-and-see buy-sell strategy

## What is a wait-and-see buy-sell agreement?

A wait-and-see buy-sell agreement creates the flexibility to postpone the decision of whether an actual buyout will be done through cross purchase or entity redemption at the death of an owner. Typically, this is accomplished by giving the first option to the business to purchase the shares of the deceased owner. If the business doesn't purchase, then surviving shareholders have an option to purchase the shares. If the shareholders don't purchase, the business is ultimately obligated to redeem the remaining ownership.

At the death of an owner, the surviving owners can accomplish entity redemption buy-sell by loaning or contributing the life insurance proceeds to the business instead of purchasing the ownership directly from the estate of a deceased owner. The business can then use the proceeds to redeem the decedent's ownership.

The previously discussed Connelly decision directly affects wait-and-see buy-sell arrangements. Connelly was a "wait and see" where each brother had a right of first refusal to purchase the shares, if they did not exercise the right, a mandatory redemption was required. The Connelly "wait and see" was funded as a redemption agreement. It is suggested that post Connelly that wait-and-see buy-sell arrangements should be funded as a cross purchase, or at the bare minimum a small redemption and a larger cross-purchase component.

## Why is the order of the options so important?

The order of the purchase options is extremely important for income tax purposes.

The ultimate obligation to purchase shares of a deceased shareholder must fall on the corporation to avoid having the stock redemption option be treated as a dividend to the surviving shareholders. If the agreement is modified to provide that the ultimate burden to purchase the shares of a deceased shareholder falls on the surviving shareholders, and the stock redemption option is chosen, the redemption by the corporation would fulfill an obligation of the shareholders to purchase the shares.

In that case, the IRS could successfully argue that the payment of the proceeds to the deceased shareholder's estate is on behalf of the surviving shareholders who had an obligation to purchase the shares, making the payment a dividend distribution to the surviving shareholders. This result is avoided as long as the ultimate liability to purchase the shares falls on the corporation.



1

**Business has  
first option**

2

**Surviving owners  
have next option**

3

**Business must  
buy stock**

### **When do you use the entity redemption option?**

The option to use the entity redemption approach has been included for those situations in which there are earnings and profits to be eliminated, or the surviving shareholders wish to remove surplus from the corporation. In the case of earnings and profits, the complete redemption of a decedent's shares eliminates his or her pro rata share of the corporate earnings and profits.

Cash surplus can be removed from the corporation by simply using the surplus to affect the stock redemption, allowing the surviving shareholders to keep all or part of the life insurance death benefits. The effect is that corporate surplus is utilized, and the surviving shareholders end up with more cash from the retained death benefits. Since the surviving shareholders receive their cash from the life insurance, which is included in the business valuation, there should be no distribution of surplus to the surviving shareholders which could be taxed as dividends. In effect, a tax-free distribution of surplus is accomplished.

### **Why, if the entity redemption is utilized, must there be a complete redemption?**

The redemption option should be chosen if it will be treated as a complete redemption of all shares owned by the decedent's estate or if the redemption qualifies under IRC Section 303. If the decedent's estate is considered as owning any stock other than the deceased shareholder's shares under the attribution rules of Section 318, then the stock redemption option should only be used if, and to the extent that, the distribution is treated as a payment in exchange for the stock under IRC Section 303. If, or to the extent that, Section 303 does not apply, then the option will usually be used when the attribution rules present a problem.

# Preface to wait-and-see buy-sell agreement

This specimen wait-and-see stock purchase agreement is an example of how counsel might draft such a document. This specimen should be used only as a guide. It outlines basic provisions usually included in such agreements. This specimen agreement is not intended as a final draft.

Counsel should revise it as necessary to meet the clients' needs. **Counsel alone is responsible for the actual wording of the final stock wait and see stock purchase agreement.** Neither Securian Financial nor its representatives are engaged in the practice of law; these specimen agreements are intended for illustrative purposes and counsel must draft a wait-and-see stock purchase agreement appropriate for his or her client.

## Specimen resolution authorizing wait-and-see buy-sell agreement

I, [NAME OF SECRETARY] Secretary of [NAME OF CORPORATION], a corporation duly organized and existing under and by virtue of the laws of the State of [STATE], DO HEREBY CERTIFY:

That on the [DAY] day of [MONTH], [YEAR], a meeting of the Board of Directors of the Corporation was held at [ADDRESS], at which a quorum was present, and the following resolution was unanimously adopted by the Board of Directors:

The Corporation desires to provide for harmonious and successful management of the Corporation, and wishes to provide for the successful continuation of the Corporation beyond the death of a stockholder; and

The Corporation wishes to protect itself against the financial expenses that would arise on the death of a stockholder.

THEREFORE, IT IS RESOLVED:

That a Wait-and-See Stock Purchase Agreement, a copy of which is attached to and made a part of this Resolution, is approved and the [TITLE OF APPROPRIATE OFFICER] is expressly authorized and directed to execute the agreement on the Corporation's behalf;

*(Formalities of execution are governed by local law.)*

WITNESSING THE ADOPTION OF THIS RESOLUTION, I have signed and stamped the seal of the Corporation hereunder in the City of [CITY], State of [STATE], on this [DAY] day of [MONTH], [YEAR].

---

Signature of Secretary

---

Name

## **Specimen wait-and-see buy-sell agreement**

This agreement is entered into on the [DAY] day of [MONTH], [YEAR], by and between [NAME], of [ADDRESS], and [NAME], of [ADDRESS], hereinafter called "stockholders" and [CORPORATE NAME], a Corporation with its principal office located at [CORPORATE ADDRESS], hereinafter called the "Corporation."

The stockholders own stock in the Corporation in the amounts set forth in attached Schedule A. Each stockholder wishes to make all of their stock subject to the terms of this agreement.

The stockholders desire to ensure the continuity of management of the Corporation by providing for the purchase of a stockholder's stock by the Corporation or by the other stockholders in the event a stockholder dies or desires to sell any of his/her shares during his/her lifetime. In consideration of the promises in this agreement, the parties bind themselves as follows:

### **Article 1: Sale of stock upon death**

Upon the death of a stockholder, the legal representative of the estate of the deceased stockholder shall give written notice thereof to the Corporation and all stockholders. After receiving notice, the surviving stockholders shall have an option to purchase, and the estate of the decedent shall sell all or part of the shares of stock now owned or later acquired by the stockholder. This option of the surviving stockholders shall expire [DAYS] days after receiving notice. If this right is not exercised, or is exercised in part, the Corporation shall purchase the remaining shares within [DAYS] days of the expiration of the stockholder's option. The sale price shall be determined in accordance with Article 3, upon the conditions set forth in Article 4.

### **Article 2: Sale of stock during lifetime**

If a stockholder(s) desires to sell part or all of his/her shares of stock at any time during his/her lifetime, he/she shall first give written notice to the other stockholders, which upon receipt of the notice, shall have [DAYS] days to purchase such shares of stock at the price established in accordance with Article 3. Each stockholder may purchase the percentage of the stock equal to the ratio of the stock owned by the departing stockholder's stock divided by the total stock owned by all stockholders.

If, or to the extent that, said shares of stock are not purchased within the stated period, the Corporation shall purchase the remaining within [DAYS] days at the price established in accordance with Article 3. If neither the Corporation nor the stockholders execute a purchase, the stockholder desiring to sell the shares may dispose of them in any lawful manner available, but not at a price less than that established in accordance with Article 3, without first offering to sell the shares to the corporation and stockholders at such a lesser price.

### **Article 3: Value of stock**

The value of the stock, as determined by the Corporation and the stockholders, is \$[PRICE] per share. Added to price per share will be any death proceeds receivable by the Corporation. At the end of each fiscal year, or within [DAYS] days thereafter, the Corporation and the stockholders shall redetermine the value of the stock. The new stock value shall be attached to this agreement on Schedule B and shall be signed by and binding on all the parties to this agreement.

If a stockholder dies within twelve (12) months of the last stock price redetermination, that price shall be used. If more than twelve (12) months have passed since the last redetermination, then qualified appraisers shall be appointed to determine the value, as follows:

The Corporation shall have the opportunity to appoint, at its own cost, a qualified appraiser, within [DAYS] days of appointment of a legal representative to the decedent's estate. The legal representative of the deceased stockholder may do the same. If only one party appoints a qualified appraiser within the [DAYS] days, that appraiser shall unilaterally establish the value for the shares of stock by a written opinion.

If both parties appoint a qualified appraiser within the [DAYS] days, those appraisers shall establish a value in a single written opinion agreed to by them. If they cannot agree, they shall together appoint a qualified appraiser whose sole written opinion shall establish the appraised value.

For purposes of this section, a "qualified appraiser" is a professional appraiser or Certified Public Accountant who is qualified by experience and ability to appraise such shares of stock. The appointment of a qualified appraiser shall be made by a written instrument delivered to the other party.

Notwithstanding the above procedure, the legal representative and the Corporation may accept as controlling the last valuation made. It is the intent of the parties that the value of a stockholder's interest as determined does include goodwill.

### **Article 4: Purchase of decedent's stock**

Upon the death of a stockholder, the surviving stockholders shall have an option for [DAYS] days after the appointment of a legal representative of the decedent's estate, to purchase all or part of the decedent's stock in the Corporation for the value determined in Article 3. Each surviving stockholder may purchase the percentage of the decedent's stock equal to the ratio of stock owned by the surviving stockholder divided by the total shares owned by all surviving stockholders.

If, or to the extent that, the surviving stockholders do not purchase all of the stock then owned by the deceased stockholder's estate, the Corporation shall redeem such stock. With respect to purchases made by surviving stockholders, the surviving stockholders shall immediately collect the proceeds of the policies owned by him/her on the life of the deceased stockholder for purposes of this agreement and apply as much of the proceeds as necessary to purchase the shares of the deceased stockholder.



If the life insurance proceeds are insufficient, the surviving stockholders or the Corporation may pay the balance either in one sum or by executing and delivering a negotiable promissory note, provided such purchases follow the sequence set forth above. The promissory note shall be payable in [NUMBER] equal (monthly, annual) installments, the first of which shall be payable to the decedent's legal representative, or a designated party, [MONTHS] months after the death of the stockholder, together with interest at the rate of [PERCENTAGE] percent per year on the unpaid balance. Such note shall provide that the unpaid balance becomes payable immediately upon default. Missing an installment payment by more than [DAYS] days will be considered a default. The purchasers shall have the right to pay off any and all installments prior to the actual due date without penalty.

Upon receipt of the entire purchase price in cash and/or note, as provided in this agreement, the legal representative shall transfer the decedent's stock to the Corporation or surviving stockholder(s) as appropriate. The Corporation or surviving stockholder(s) shall pledge all of the decedent's stock acquired as security for the unpaid balance of any note but may exercise all rights of ownership in the stock prior to a default.

#### **Article 5: Insurance policies**

In order to assure funds are available to purchase the shares of the deceased stockholder, the stockholders may have purchased insurance on the lives of each other. Any life insurance policy owned by the company will be included in the value of the company at the date of death of any stockholder. The details of the insurance are set forth in Schedule C attached.

Each stockholder may purchase additional insurance on the lives of any of the other parties to this agreement, or anyone who may later become a party to this agreement. Additional purchases of insurance shall also be listed on Schedule C.

Each stockholder shall be the beneficiary and absolute owner of all policies purchased by him/her on the life of the other stockholder(s) for purposes of this agreement. Each stockholder shall retain physical custody of the policies and pay all premiums necessary to keep the policies in force. Until termination of this agreement, no stockholder shall do any of the following to the policies: take a withdrawal from the policy, borrow upon the policies, receive cash dividends, or pledge or assign the policies as security for any loan or indebtedness. Nor shall any stockholder otherwise modify or impair any of the rights or values of the policies, except with written consent of the insured stockholder(s).

Any life insurance policies owned by the Corporation will be included in the date of death valuation of the business and may or may not be sufficient to redeem a deceased shareholders' share of the business.

**Article 6: Purchase of policy by insured**

Upon the death of a stockholder, each surviving stockholder shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on his/her life that the decedent purchased because of this agreement. In the event a stockholder sells all his/her stock during his/her lifetime, he/she shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on his/her life under this agreement. Likewise, each of the other stockholders shall have the right to purchase, during the same time, all contracts of insurance on their lives under this agreement owned by the selling stockholder. Upon termination of this agreement for any reason, each stockholder shall have the right to purchase, within [DAYS] days thereafter, all contracts of insurance on their lives owned by other stockholders because of this agreement.

The purchase price for each policy under this Article shall be the net cash value plus any unearned premium. The net cash value equals the policy's cash value less indebtedness. If the right to purchase the policy is not exercised, the policy owner may hold or dispose of the policy at his/her discretion.

**Article 7: Endorsement of stock certificates**

The stock certificates for all stock of the corporation subject to this agreement shall be endorsed as follows: "The sale or transfer of this certificate is subject to a buy-sell agreement dated [DAY] [MONTH], [YEAR]."

**Article 8: Amendment and termination**

This agreement may be amended or terminated by a written agreement signed by all parties. This agreement shall be terminated by the bankruptcy, receivership, or dissolution of the corporation.

**Article 9: Liability of insurance company**

Any insurance company issuing policies of insurance pursuant to this agreement shall have no liability except as set forth in the policy. The payment by an insurance company pursuant to the terms of any policies, which are subject to this agreement, shall be a complete discharge of the company from all claims, suits and liability.

**Article 10: Choice of law**

This agreement shall be construed in accordance with the laws of the State of [STATE].

**Article 11: Heirs, executors and administrators**

This agreement shall be binding upon the stockholders individually and their respective heirs, executors and administrators.

## **Article 12 : Disposition by spouse (optional, community property)**

In the event that the spouse of a stockholder predeceases him or her and makes a testamentary disposition of his or her community interest in the stock, then:

**Transfer to surviving spouse.** To the extent that such disposition is to his or her surviving spouse, or to a trust or trusts of which he or she is sole trustee, the transfer shall not be subject to the offer requirements under this agreement, but the interests of transfer shall, in the hands of the transferee, be subject to this agreement fully as if still owned by the stockholder. This includes, but is not limited to, the duty of the transferee to sell such interests as provided for under the terms of this agreement.

**Transfer to others.** Except as provided above, no such disposition by such spouse shall be effective without him or her first offering such interest as follows: To his or her surviving spouse, the entirety thereof on the same terms and at the same proportionate price as applies to a transfer by a stockholder during his or her lifetime under Article 2, but without any prior offer to the corporation or to the other stockholders.

If his or her surviving spouse fails to accept such offer, then to the other stockholders, the entirety thereof on the same terms and for the same proportionate price as applies to a transfer by stockholder during his or her lifetime under Article 2, but without any prior offer to the corporation.

## **Article 13: Acknowledgment (optional, community property)**

Each stockholder and his or her spouse declares that he or she, respectively, is completely informed as to the facts relating to the subject matter of this agreement and as to their rights and liabilities; enters into this agreement voluntarily after receiving advice (or after having had the opportunity to receive advice) of independent counsel of his or her own choosing; has given mature thought to making this agreement; has carefully read each provision of this agreement; and fully and completely understands each provision of this agreement, both as to subject matter and legal effect.

(Formalities of execution are governed by local law.)

The parties have executed this agreement at [ADDRESS], in the County of [COUNTY], State of [STATE], on this [DAY] day of [MONTH], [YEAR].

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Stockholder

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Stockholder

**Consent of spouses**

We, the undersigned spouses of the stockholders, hereby acknowledge that we have read the foregoing agreement and consent to its terms, to the disposition made therein of any interest we have in the stock of the corporation or the life insurance policies described under Schedule C as community or separate property, and to the price now or hereafter determined by the stockholders.

\_\_\_\_\_  
Spouse

\_\_\_\_\_  
Spouse

**Schedule A**

The amount of stock in the corporation owned by each stockholder is as follows:

Stockholder	Number of shares
1.	
2.	
3.	
4.	
5.	

**Schedule B**

This [DAY] day of [MONTH], [YEAR], the stockholders have determined the value of the stock of the corporation for purposes of this agreement to be \$[PRICE] per share.

\_\_\_\_\_  
Stockholder

\_\_\_\_\_  
Stockholder

**Schedule C**

Name	Policy number	Insurance company	Face amount
_____			
_____			
_____			
_____			

# One-way buy-sell strategy

## What is a one-way buy-sell?

A one-way buy-sell is where the sole owner of a business enters into a buy-sell arrangement with either a key employee or a family member. The key employee or family member is the owner and beneficiary of a policy on the business owner. The business bonuses premium payments to the key employee and upon the death of the business owner, the key employee or family member is required to purchase the ownership from the estate of the deceased owner. The key employee or family member then becomes sole owner of the business.

## Set up

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## Death of a business owner

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# Preface to specimen one-way buy-sell purchase agreement

This specimen one-way buy-sell agreement is an example of how counsel might draft such a document. This specimen should be used only as a guide. It outlines basic provisions usually included in such agreements. This specimen agreement is not intended as a final draft.

Counsel should revise it as necessary to meet the clients' needs. **Counsel alone is responsible for the actual wording of the final agreement.** Neither Securian Financial nor its representatives are engaged in the practice of law; these specimen agreements are intended for illustrative purposes and counsel must draft a specimen one-way buy-sell agreement appropriate for his or her client.

## Specimen one-way buy-sell purchase agreement

This agreement is entered into on the [DAY] day of [MONTH], [YEAR], by and between [BUSINESS OWNER], of [ADDRESS], hereinafter called "Stockholder" and [NAME OF PURCHASER], of [ADDRESS], and, hereinafter called "Purchaser."

The purpose of this Agreement is to provide for the purchase by Purchaser of Stockholder's corporate interest in Corporation. The stockholder owns stock in the Corporation in the amount set forth in attached Schedule A. Stockholder agrees to endorse his stock certificates to reflect that they are subject to the Agreement.

Stockholder and Purchaser agree that such purchase and sale shall occur upon the death, retirement, or withdrawal of Stockholder. In consideration of the promises in this agreement, the parties bind themselves as follows:

### Article 1: Sale of stock upon death of stockholder

Upon the death of Stockholder, Stockholder's personal representative shall sell, and the Purchaser shall buy, all of the deceased Stockholder's corporate stock. The price will equal the value as provided in this Agreement. Any life insurance death proceeds owned by the company will be included in any death time sale of stock. The deceased Stockholder's estate shall provide such instruments as may be necessary to complete the sale and purchase hereunder. Any stock subsequently acquired by Stockholder shall likewise be subject to purchase and sale under the terms of this Agreement.

### Article 2: Sale of stock during lifetime of stockholder

If a Stockholder desires to sell part or all of his/her shares of stock at any time during his/her lifetime or upon retirement, he/she shall be precluded from selling or offering to sell such stock to any other person or institution until he/she has offered to the Purchaser at the price determined under this Agreement. The Purchaser shall have [DAYS] days within which to accept this offer to sell and, if not exercised within such period, the withdrawing or retiring Stockholder may sell to such other person or institution as he so desires provided, however, that he/she shall not sell such interest without first offering it to the Purchaser at the price and terms offered to such other parties.

In the event the Purchaser elects to purchase the retiring or withdrawing Stockholder's interest, such purchase shall be made on an installment sale basis. The Purchaser may exercise the life insurance policy loan or cash withdrawal options on the policy insuring Stockholder's life in meeting this lifetime purchase obligation. The Purchaser shall make an initial down payment in cash of [PERCENTAGE] percent of the purchase price as determined in Article 3. The purchase balance shall be paid in [NUMBER] equal annual installments commencing with the annual anniversary of the initial down payment.

The installment amounts due under the unpaid balance shall be evidenced by promissory notes with provision for annual payments on principal for [NUMBER] year term with interest rate of [PERCENTAGE] percent per annum. The note(s) shall provide for optional acceleration of maturity in the event of a default in payment of principal or interest and, at the option of the retiring or withdrawing Stockholder, such notes may be additionally secured by a pledge of all or a portion of his Corporation stock.

### **Article 3: Value of stock**

The value of the stock held and owned by Stockholder is:

\$\_\_\_\_\_ (\_\_\_\_\_%)

In arriving at the stock value, the Stockholder and Purchaser have obtained independent appraisers to determine the current market value of all Corporation assets. Any life insurance death proceeds that may be owned by the Corporation shall be included such value. Such value may be changed from time to time by the parties by endorsement opposite their signatures in Schedule B.

If a stockholder dies within twelve (12) months of the last stock price redetermination, that price shall be used. If more than twelve (12) months have passed since the last redetermination, however, then qualified appraisers shall be appointed to determine the value, as follows:

The surviving stockholder(s) shall have the opportunity to appoint, at their own cost, a qualified appraiser, within [DAYS] days of appointment of a legal representative to the decedent's estate. The legal representative of the deceased stockholder may do the same. If only one party appoints a qualified appraiser within the [DAYS] days, that appraiser shall unilaterally establish the value for the shares of stock by a written opinion.

If more than one party appoints a qualified appraiser within the [DAYS] days, those appraisers shall establish a value in a single written opinion agreed to by them. If they cannot agree, they shall together appoint a qualified appraiser whose sole written opinion shall establish the appraised value.

For purposes of this section, a "qualified appraiser" is a professional appraiser or Certified Public Accountant who is qualified by experience and ability to appraise such shares of stock. The appointment of a qualified appraiser shall be made by notifying the other party in writing of the appointment.

Notwithstanding the above procedure, the legal representative and the surviving stockholder(s) may accept as controlling the last valuation made. It is the intent of the parties that the value of the stockholder's interest as determined does include goodwill.

#### **Article 4: Purchase of decedent's stock**

Upon the death of Stockholder, the Purchaser shall, within [DAYS] days after the appointment of a legal representative of the decedent's estate, proceed to purchase all of the decedent's stock in the corporation for the value determined in Article 3.

The Purchaser shall immediately collect the proceeds of the policies owned by him/her on the life of the deceased Stockholder for purposes of this agreement, and apply as much of the proceeds as necessary to purchase the shares of the deceased Stockholder. If the life insurance proceeds are insufficient, the Purchaser may pay the balance either in one sum or by executing and delivering a negotiable promissory note. Such note shall be payable in [NUMBER] equal (monthly, annual) installments, the first of which shall be payable to the decedent's legal representative, or a designated party, [MONTHS] months after the death of the Stockholder, together with interest at the rate of [PERCENTAGE] percent per year on the unpaid balance. Such note shall provide that the unpaid balance becomes payable immediately upon default. Missing an installment payment by more than [DAYS] days will be considered a default. The Purchasers shall have the right to pay off any and all installments prior to the actual due date without penalty.

Upon receipt of the entire purchase price in cash and/or note, as provided in this agreement, the legal representative shall transfer the decedent's stock to the Purchaser. The Purchaser shall pledge all of the decedent's stock acquired as security for the unpaid balance of any note, but may exercise all rights of ownership in the stock prior to a default.

#### **Article 5: Insurance policies**

In order to provide liquidity to purchase the shares of the deceased Stockholder, the Purchaser has purchased insurance on the life of the Stockholder. Any life insurance policy owned by the company will be included in the value of the company at the date of death of any stockholder. The details of the insurance are set forth in Schedule C attached.

Each stockholder may purchase additional insurance on the lives of any of the other parties to this agreement, or anyone who may later become a party to this agreement. Additional purchases of insurance shall also be listed on Schedule C.

Purchaser shall be the beneficiary and absolute owner of all policies purchased by him/ her on the life of the Stockholder for purposes of this agreement.

Purchaser shall retain physical custody of the policies and pay all premiums necessary to keep the policies in force. Until termination of this agreement, no stockholder shall do any of the following to the policies: take a withdrawal from the policy, borrow upon the policies, receive cash dividends, or pledge or assign the policies as security for any loan or indebtedness. Any life insurance death proceeds that may be owned by the Corporation shall be included in the business valuation.

Nor shall any stockholder otherwise modify or impair any of the rights or values of the policies, except with written consent of the insured stockholder(s).



**Article 6: Endorsement of stock certificates**

The stock certificates for all stock of the corporation subject to this agreement shall be endorsed as follows: "The sale or transfer of this certificate is subject to a buy and sell agreement dated [DAY] [MONTH], [YEAR]."

**Article 7: Amendment and termination**

This agreement may be amended or terminated by a written agreement signed by all parties. This agreement shall be terminated by the bankruptcy, receivership or dissolution of the corporation.

**Article 8: Liability of insurance company**

Any insurance company issuing policies of insurance pursuant to this agreement shall have no liability except as set forth in the policy. The payment by an insurance company pursuant to the terms of any policies, which are subject to this agreement, shall be a complete discharge of the company from all claims, suits and liability.

**Article 9: Choice of law**

This agreement shall be construed in accordance with the laws of the State of [STATE].

**Article 10: Heirs, executors and administrators**

This agreement shall be binding upon the stockholders individually and their respective heirs, executors and administrators.

**Article 11: Disposition by spouse (optional, community property)**

In the event that the spouse of a Stockholder predeceases him or her and makes a testamentary disposition of his or her community interest in the stock, then:

**Transfer to surviving spouse.** To the extent that such disposition is to his or her surviving spouse, or to a trust or trusts of which he or she is sole trustee, the transfer shall not be subject to the offer requirements under this agreement, but the interests of transfer shall, in the hands of the transferee, be subject to this agreement fully as if still owned by the stockholder. This includes, but is not limited to, the duty of the transferee to sell such interests to the other stockholders, and their duty to purchase it, on the stockholder's death.

**Transfer to others.** Except as provided above, no such disposition by such spouse shall be effective without him or her first offering such interest as follows: To his or her surviving spouse, the entirety thereof on the same terms and at the same proportionate price as applies to a transfer by a stockholder during his or her lifetime under Article 1, but without any prior offer to the corporation or to the other stockholders.

If his or her surviving spouse fails to accept such offer, then to the other stockholders, the entirety thereof on the same terms and for the same proportionate price as applies to a transfer by stockholder during his or her lifetime under Article 1, but without any prior offer to the corporation.

## Article 12: Acknowledgment (optional, community property)

Stockholder and his/her spouse declares that he or she, respectively, is completely informed as to the facts relating to the subject matter of this agreement and as to their rights and liabilities; enters into this agreement voluntarily after receiving advice (or after having had the opportunity to receive advice) of independent counsel of his or her own choosing; has given mature thought to making this agreement; has carefully read each provision of this agreement; and fully and completely understands each provision of this agreement, both as to subject matter and legal effect.

(Formalities of execution are governed by local law.)

The parties have executed this agreement at [ADDRESS], in the County of [COUNTY], State of [STATE], on this [DAY] day of [MONTH], [YEAR].

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Stockholder

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Purchaser

## Consent of spouse

We, the undersigned spouses of the stockholders, hereby acknowledge that we have read the foregoing agreement and consent to its terms, to the disposition made therein of any interest we have in the stock of the corporation or the life insurance policies described under Schedule C as community or separate property, and to the price now or hereafter determined by the stockholders.

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Spouse

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Spouse

## Schedule A

The amount of stock in the corporation owned by each stockholder is as follows:

Stockholder	Number of shares
1.	
2.	
3.	
4.	
5.	

**Schedule B**

This [DAY] day of [MONTH], [YEAR], the stockholders have determined the value of the stock of the corporation for purposes of this agreement to be \$[PRICE] per share.

\_\_\_\_\_  
Stockholder

\_\_\_\_\_  
Purchaser

**Schedule C**

Name	Policy number	Insurance company	Face amount
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

**Employer Owned Life Insurance Policy  
Insured's Acknowledgment of Disclosure and Consent**



**Securian Life Insurance Company**

Life New Business • 400 Robert Street North, St. Paul, MN 55101-2098

**Employee/Proposed Insured - Information (please print)**

Name	Date of birth
Street address, city, state, zip code	Telephone number

**Employer Information**

Legal name
Street address, city, state, zip code
Telephone number

**I, the employee / proposed insured, acknowledge disclosure and consent that:**

- The employer intends to insure my life.
- I authorize and allow the employer to purchase such life insurance on my life.
- The maximum face amount for which I will be insured is: \$ \_\_\_\_\_
- The employer will be the beneficiary of all or part of the life insurance policy proceeds.
- Such life insurance coverage may continue after my employment with employer has terminated.
- I have received this written Acknowledgment of Disclosure and Consent form from the employer.

Signature of employee/proposed insured	Date
<b>X</b>	

**Employer - please review the following:**

- This form must be executed and signed before the policy is issued.
- The execution of this form must involve an appropriate insured under IRC Section 101(j).
- Copies of this Acknowledgment of Disclosure and Consent form are retained by the Employer.
- For survivor life insurance policies, a separate form must be completed and retained for each of the proposed insureds.
- This form and information is not intended as tax, legal or accounting advice. It is provided only as a convenience. Taxpayers should consult with their own legal counsel for guidance in order to determine IRC Section 101(j) requirements and whether a specific planning strategy is suitable for any particular individual.

# Employer Owned Life Insurance Policy Insured's Acknowledgment of Disclosure and Consent



Minnesota Life Insurance Company - a Securian Financial company  
Life New Business • 400 Robert Street North • St. Paul, Minnesota 55101-2098

## Employee/Proposed Insured - Information (please print)

Name			Date of birth
Address	City	State	Zip code
Telephone number			

## Employer Information

Legal name			
Address	City	State	Zip code
Telephone number			

### I, the employee/proposed insured, acknowledge disclosure and consent that:

- The employer intends to insure my life.
- I authorize and allow the employer to purchase such life insurance on my life.
- The maximum face amount for which I will be insured is: \$\_\_\_\_\_
- The employer will be the beneficiary of all or part of the life insurance policy proceeds.
- Such life insurance coverage may continue after my employment with employer has terminated.
- I have received this written Acknowledgment of Disclosure and Consent form from the employer.

Signature of employee/proposed insured <b>X</b>	Date
--	------

### Employer - please review the following:

- This form must be executed and signed before the policy is issued.
- The execution of this form must involve an appropriate insured under IRC Section 101(j).
- Copies of this Acknowledgment of Disclosure and Consent form are retained by the Employer.
- For survivor life insurance policies, a separate form must be completed and retained for each of the proposed insureds.
- This form and information is not intended as tax, legal or accounting advice. It is provided only as a convenience. Taxpayers should consult with their own legal counsel for guidance in order to determine IRC Section 101(j) requirements and whether a specific planning strategy is suitable for any particular individual.

Life insurance products contain charges, such as Cost of Insurance Charge, Cash Extra Charge, and Additional Agreements Charge (which we refer to as mortality charges), and Premium Charge, Monthly Policy Charge, Policy Issue Charge, Transaction Charge, Index Segment Charge, and Surrender Charge (which we refer to as expense charges). These charges may increase over time, and these policies may contain restrictions, such as surrender periods. Policyholders could lose money in these products.

Policy loans and withdrawals may create an adverse tax result in the event of lapse or policy surrender, and will reduce both the surrender value and death benefit. Withdrawals may be subject to taxation within the first 15 years of the contract. Clients should consult their tax advisor when considering taking a policy loan or withdrawal.

Guarantees are based on the claims-paying ability of the issuing life insurance company.

Please keep in mind that the primary reason to purchase life insurance is the death benefit.

This information is a general discussion of the relevant federal tax laws provided to promote ideas that may benefit a taxpayer. It is not intended for, nor can it be used by any taxpayer for the purpose of avoiding federal tax penalties. Taxpayers should seek the advice of their own advisors regarding any tax and legal issues specific to their situation.

These are general marketing materials and, accordingly, should not be viewed as a recommendation that any particular product or feature is appropriate or suitable for any particular individual. These materials are based on hypothetical scenarios and are not designed for any particular individual or group of individuals (for example, any demographic group by age or occupation). It should not be considered investment advice, nor does it constitute a recommendation that anyone engage in (or refrain from) a particular course of action. If you are looking for investment advice or recommendations, you should contact your financial professional.

Insurance products are issued by Minnesota Life Insurance Company in all states except New York. In New York, products are issued by Securian Life Insurance Company, a New York authorized insurer. Minnesota Life is not an authorized New York insurer and does not do insurance business in New York. Both companies are headquartered in St. Paul, MN. Product availability and features may vary by state. Each insurer is solely responsible for the financial obligations under the policies or contracts it issues.

Securian Financial is the marketing name for Securian Financial Group, Inc., and its subsidiaries. Minnesota Life Insurance Company and Securian Life Insurance Company are subsidiaries of Securian Financial Group, Inc.



PREPARE  
PROTECT  
SECURE

[securian.com](https://securian.com)

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