# Life & Disability

## *Cross-Purpose Buy-Sell Agreements*

Health.

Wealth.

Life.

*In Pursuit of What Matters Most.*

### What is a Cross-Purchase Buy-Sell Arrangement?

A cross-purchase buy-sell arrangement is an agreement in which each business owner agrees to buy the interest of the others in the event of death, disability or retirement.

### How Does a Buy-Sell Arrangement Work?

In a cross-purchase buy-sell arrangement the owners must agree amongst themselves on a business continuation plan. Each owner agrees to buy the others' shares in the event of death or retirement.

### Funding with Life Insurance

In this arrangement, each owner purchases a life insurance policy on the other. For example, if there are three owners, then there are six policies. The formula for determining this number is the number of owners multiplied by the number of owners subtracted by one. Each owner will pay the premiums out of his or her personal funds. The premium payments are not tax deductible.

### Why Use Life Insurance

Life insurance is an excellent choice to fund a cross-purchase buy-sell arrangement because the death benefit proceeds will be received by the surviving partner income tax free. Life insurance also has the potential for tax deferred accumulation. When using life insurance in a cross-purchase agreement, the value of the entity does not increase because the individuals own the contracts, not the business.

### Advantages of Cross-Purchase Buy-Sell Arrangements

- The purchasing owners receive a step-up in cost basis in the acquired business interest, which reduces future tax gain.
- The business does not reflect the value of the life insurance policies on its balance sheet. Thus the value of the business does not increase.
- The business is not a party to the cross-purchase arrangement, hence the life insurance is not subject to Alternative Minimum Tax (AMT).

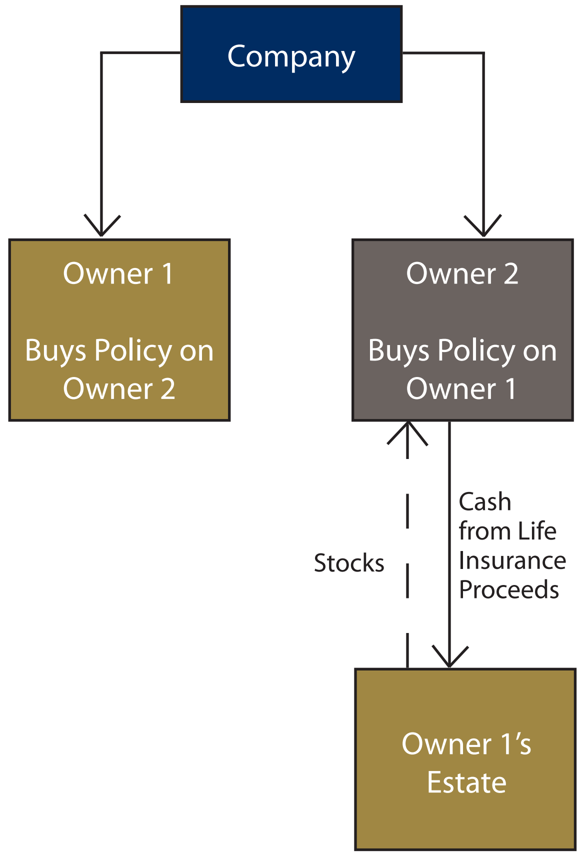
### Disadvantages of Cross-Purchase Buy-Sell Arrangements

- The plan may require several different policies and does not work well for organizations with more than five owners.
- The owners may be in a higher tax bracket than the business, resulting in a higher cost of insurance.
- The life insurance premiums are not tax-deductible.

HORAN® Health. Wealth. *Life.*

# Cross-Purchase Buy-Sell Agreement

| | Cross-Purchase |
|---|---|
| What is it? | An arrangement in which each owner agrees to buy the business interest of another owner. |
| How does it work? | Owners enter into a business continuation agreement amongst themselves. |
| What are the funding options? | Life insurance, sinking fund, installment method, borrowed funds. |
| Funding with life insurance | Each owner purchases a life insurance policy on the other owner(s). |
| Premiums | Paid by each contract owner and are not tax deductible. |
| Corporate creditors and insurance | Life insurance is not subject to corporate creditors. |
| Alternative Minimum Tax (AMT) | No potential corporate alternative minimum tax or accumulated earnings tax. |
| Business valuation when using insurance | The life insurance contracts will not increase the value of the business as they will be individually owned. |




## About HORAN

The daily work at HORAN originates from a belief that three things matter most to our clients: access to quality, affordable health care, the ability to build long-term wealth and the counsel to achieve financial goals and protect assets for a lifetime. We deliver Health, Wealth and Life services to individuals, families and employers designed around essential client needs.

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