

Buy Sell Agreements – Continued

How Does Insurance Fit Into Each Plan?

No matter what you choose, be sure to fund your buy-sell agreement properly. For many, permanent life insurance has been a smart choice. Insurance is a cost effective way to ensure that the funds are available when needed most. Insurance proceeds allow you to purchase the deceased owner's share of the business. Proceeds are available immediately when death occurs.

Cross Purchase Plan & Life Insurance

Each owner applies for, owns, and pays the life insurance premiums on the other owners' lives. The surviving owners use the life insurance proceeds to purchase the deceased owner's interest.

Advantages:

Surviving owners receive a step-up in basis for the deceased's business interest that they purchase. Business (C corporation) avoids exposure to the alternative minimum tax. Corporate creditors cannot reach the insurance proceeds. Corporation can pay premiums if treated as additional compensation to shareholders/employees (under a Section 162 Bonus Plan or Split Dollar Arrangement).

Disadvantages:

Plan becomes more difficult to administer as the number of shareholders increases. May cost more to the shareholders if the corporation is in a lower tax bracket.

Entity Plan & Life Insurance

The business applies for, owns, and pays the life insurance premiums on each shareholder's life. The business uses the life insurance proceeds to purchase the deceased's business interest. (Please note that the entity plan is similar to a stock redemption plan.)

Advantages:

Premium dollars may be cheaper if the business is in a lower tax bracket than the owners. Permits the pooling of premium obligations. No question arises as to "unreasonable compensation," as it often does when salaries are increased to pay the premiums for life insurance used to fund a cross-purchase plan.

Read the rest of this series in the next issues!

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1Section 2703 of the Internal Revenue Code applies to buy-sell agreements entered into after October 8, 1990, or substantially modified after this date, and applies only to family-owned companies. 2In a C corporation, you must be aware of alternative minimum tax considerations.

3Life insurance proceeds and inside buildups of available cash values are included in adjusted current earnings for purposes of the corporate alternative minimum tax.

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