

## Buy Sell Agreements 3

### ***Disadvantages:***

- State law often restricts redemptions unless they are from surplus. (Life insurance proceeds provide instant surplus!)
- Surviving owner's basis in the stock of a C corporation remains the same, even though the overall value of one's ownership may increase. Survivor's basis is increased in an S corporation.
- Corporate creditors *can* reach the cash value of permanent life insurance and policy proceeds.
- Potential accumulated earnings tax problems may exist.
- Potential alternative minimum tax considerations in a C corporation.<sup>3</sup>
- Voting power may be altered in an undesirable way. Consider a business where the father owns 30%, his son 30%, and an unrelated key employee owns 40%. If the business redeems the father's stock at death, the unrelated key employee now owns a majority of the outstanding stock and effectively controls the business.
- Constructive ownership (i.e., attribution) may result in significant tax consequences.

### ***Trustee Plan (or Escrow Agent Plan) & Life Insurance***

The trustee is the beneficiary of a life insurance contract on each shareholder. The trustee collects the proceeds on the decedent's life and delivers them to his or her estate. The trustee holds all shares endorsed in blank, and delivers the deceased's share to the other shareholders (cross purchase) or to the corporation (redemption or entity plan purchase).

### ***Advantages:***

- Ensures that the purchase will be carried out.
- Surviving owners in a cross purchase plan receive an increase in their basis for their newly acquired interest.
- Shareholders or corporation may periodically contribute funds to the trust so the trustee can pay the premiums on the lives of the shareholders.
- Can avoid multiple required policies in cross purchase agreement.

### ***Disadvantage:***

Higher initial start-up costs may be incurred due to expenses associated with drafting the buy-sell agreement. Your advisors should note that transfer-for-value issues may arise where there are three or more stockholders.

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<sup>1</sup>Section 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.

<sup>2</sup>In a C corporation, you must be aware of alternative minimum tax considerations.

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