



AdvisorServe helps financial professionals serve their business owner clients with planning elements related to business continuity. While a solution to this issue may appear to be easy, many of the agreements we review, during the planning process, have bad tax consequences or even run counter to what the clients really want.

Common Types of Buy-Sell Agreements and Funding Methods*

STOCK-REDEMPTION OR ENTITY PURCHASE

Perhaps the most common, this arrangement sets up the business as the buyer of a deceased owner's interest. Surviving partners do not personally participate in the transaction. Funding for the unscheduled purchase of an ownership interest comes from the business. We have found that the best way to set this up is to have the business insure each party in the agreement so that, upon death, the needed funds are delivered to the company tax-free and then used to fulfill the company's obligation.

CROSS-PURCHASE

Most of our clients prefer an arrangement where the surviving owner(s) purchase the stock of the deceased owner directly. This gives the surviving owners a new and valuable basis in the company for future transactions. The same life insurance funding can be used; however, the coverage is owned by the owners on each other. Where there are multiple owners, a separate trust is often used to coordinate the coverage and avoid the need to buy more policies than necessary.

ONE-WAY

Sometimes, there is only one owner. In these arrangements, the owner designates who will be the next owner of the business by agreeing to have that person (or persons) buy the current owner's shares at a set price from the estate in the event of death. As with the other arrangements above, the successors can agree to buy out the owner over time, but this exposes the family of the deceased owner to any potential business failure. Instead, life insurance can ensure the completion of the transaction in short order.

WAIT-AND-SEE

Not sure whether to go with Redemption or Cross-Purchase? Some agreements begin with one of the two arrangements but allow the survivors to switch to the other approach if the circumstances warrant.

Four Benefits of a Buy-Sell Agreement Using Life Insurance

1. It can be an effective protection against risk related to the death of one of the owners. The control of the business can stay with the surviving owners with little impact on the balance sheet, or a need to take payments out of future earnings.
2. The deceased owner's heirs can be confident that there is a plan in place for them to be fairly compensated for the deceased's interest in the business and paid quickly.
3. Generally, proceeds are received tax-free, giving the beneficiary full flexibility to accomplish the objectives of the agreement.
4. If a cash-value life insurance policy is used, the policy's value can be repurposed if the insured retires or suffers a disability. Depending on the needs of the company, the insurance can be positioned as a sinking fund for other contingencies.

Seven Planning Questions to Ask Your Business Owner Clients Considering a Buy-Sell Agreement

1. How many business owners are there, and what is their ownership percentage?
2. What are the ages of each of the business owners or future owners?
3. What is the current value of the business?
4. How is the business structured (Partnership, Corporation, etc.)?
5. KEY QUESTION: What do owners want to happen in the event of a death among them? Is there a different scenario depending on which partner dies?
6. What is each owner's current health (insurability)?
7. What is the projected date when the agreement will no longer be needed due to a buy-out or retirement?

Business owners continue to be among the best clients advisors can serve. By helping them with the planning aspect of their buy-sell arrangements, your value as an advisor may be greatly enhanced and your ability to attract more business owner clients can increase. The advisors and support staff at AdvisorServe have extensive planning experience in these types of situations. We look forward to supporting you in serving your clients well.

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