Business planning

# Cross-purchase buy/sell arrangement

### The concept

A cross-purchase buy/sell arrangement is an agreement in which the owners of a business draw up a contract among themselves promising that if one of them passes away, retires or becomes disabled, the remaining business owners will purchase the departing business owner's interest. To fund their purchase obligations, the business owners often purchase and own insurance policies on one another's lives.

### Benefits

This arrangement provides the business owners with a ready market for their interests at a fair price. Funding a cross-purchase buy/sell arrangement with life insurance means that upon death, cash is available to immediately purchase the deceased business owner's interest. Additionally, if the purchase takes place while the business owner is alive, the policy's cash value may be used as a down payment, with the balance of the purchase price covered by installment notes.

### Tax considerations

The purchasers of the departing business owner's interest will receive a step-up in basis for their acquired interest.

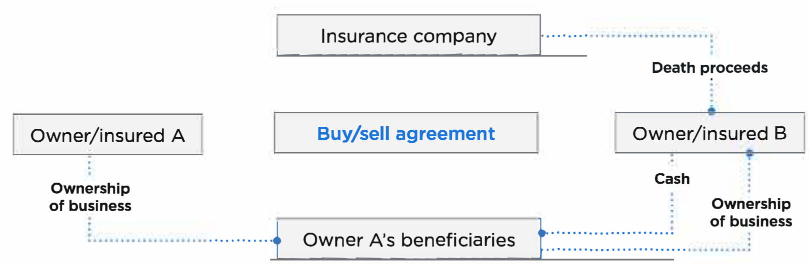
### Steps

- The business owners enter into a written buy/sell agreement providing for the purchase and sale of a departing owner's interest upon their death, disability or retirement
- The owners purchase life insurance policies on each other's lives
- Upon an owner's death, disability or retirement, a sale of the departing owner's interest to the other owners takes place

## How it works while employed

### During life


### Upon death of owner/insured A



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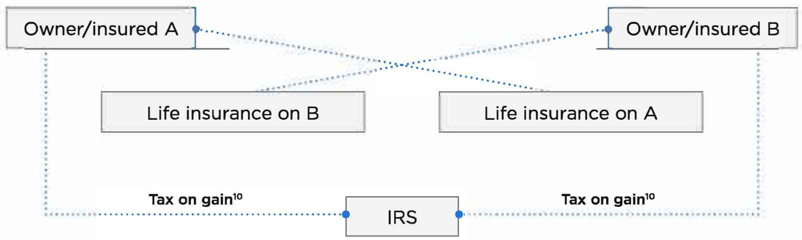
# Cross-purchase buy/sell arrangement (continued)

**Additional considerations**

- Many times, the owners will retire and want to maintain the policies for personal use now that they're no longer needed for the cross-purchase agreement
- In these cases, the policies will be transferred to the insured; this transfer is a barter transaction and is taxable to the owners on the fair market value of the policy in excess of the basis
- The insured will now be the owner of the policy and will be able to access the policy's cash value during life
- The insured's beneficiaries will receive any remaining death benefit

## How it works upon retirement

**(assuming parties wish to continue their own policies)**




[10] Generally, the fair market value of a policy is the greater of terminal reserve or the policy value. The gain, if any, in the policy is the excess of the fair market value over premiums paid, and it is taxed as ordinary income.