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CAPITAL GROUP

Buy-Sell Agreement Insurance

What is a Buy-Sell Agreement?

A buy-sell agreement is a legally binding contract that provides for the transfer of business ownership upon a "triggering event" – death, disability, retirement, divorce, bankruptcy, etc. They are integral to succession planning and are often used as life insurance policies to fund the buyout in case of a business partner's death.

The purpose of a Buy-Sell Agreement

- Creates a market for an owner's interest in the business, usually when it is needed most
- Establishes a purchase price for the business interests
- Protects owners who continue in the business interest by restricting transfer of ownership interests to outside parties
- In the case of death, it provides liquidity for deceased owner's estate to pay estate taxes or other debts of the estate

Important Factors to Consider

Choosing the right structure for a buy-sell agreement can depend on a lot of factors, including:

- How many owners are involved in the business?
- What is the business structure (e.g., C corp, S corp, partnership, LLC)?
- Who will pay the premiums?
- How much control does each owner want over his or her policy?

Risks of Forgoing a Buy-Sell Agreement

A binding buy-sell agreement between owners allows for a clean transfer of business interests when specific events occur. Events can include divorce, retirement, death, or an owner wanting to leave the company for any reason. Businesses operating without one are at risk, making buy-sell agreements a critical component of partnerships. Without a plan that clearly lays out an orderly transfer of an owner's business interests, the company stakeholders are open to:

- Tax inefficiencies
- Disputes among partners
- Time loss
- Increased expenses
- Potential litigation
- Instability for remaining owners and employees
- Uncertain management and business controls

Did You Know...?

"According to PNC, while 60% to 70% of small business owners want to pass along their business to the next generation, only 15% have an actual succession plan in place."

Why Business Owners Should Consider Buy-Sell Agreements Before The End Of The Year (Forbes.com)

Common Types of Buy-Sell Agreements

Entity Purchase	An entity purchase provides that the business will pay the owner or the owner's estate an agreed upon amount for the owner's interest in the business upon a triggering event (death, disability, or retirement). To meet the obligations under the buy-sell agreement, the business will purchase life insurance for each participating owner. Entity purchase policies are employer-owned and must comply with 101(j) to ensure the death benefit will be received tax-free.
Cross Purchase	A cross-purchase provides that each owner of the business will purchase another owner's interest in the company upon a triggering event. The cross-purchase agreement is negotiated amongst the owners of a business; this means that not all owners must participate or be included in the buy-sell obligations.
Wait and See	A hybrid buy-sell arrangement combines features of an entity purchase and a cross-purchase buy-sell agreement. To meet the obligations under the buy-sell agreement, either the business (generally preferred) or the individual owners will purchase insurance policies on the lives of the business owners.
Cross Endorsement	A cross endorsement arrangement is an alternative to the typical funding approach used with cross-purchase buy-sell agreements. Under a cross endorsement arrangement, each business owner purchases and owns a life insurance policy on his or her own life and endorses a portion of the death benefit to the other owners.
Trusteed	In a trusteed arrangement, a trustee purchases life insurance on the life of each business owner who is a party to the cross-purchase buy-sell agreement and pays the premium on such policies via contributions from the business owners. Upon the death of an owner, the trustee (1) collects the life insurance proceeds, (2) purchases the business interests from the estate of the deceased owner, and (3) distributes the business interests to the surviving owners.
Partnership	This arrangement is similar to the trusteed arrangement, however, instead of creating a trust, the business owners form a partnership. The partnership then purchases a life insurance policy for each business owner and pays the premium via contributions made to the partnership each year by the business owners.

How Can Fort Pitt Capital Group Help?

At Fort Pitt, we believe insurance is an integral part of a holistic financial plan, so we offer our clients in-house risk mitigation solutions. Our clients benefit by receiving advice through our fiduciary role, which means we will act in your best interest and only recommend products based on your needs. Talk to your advisor today to learn more.

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