# How to Fund a Death-Time Buy-Sell Agreement

There are four methods by which a buy-sell agreement can be funded on the death of a partner or shareholder. Each carries their own advantages and disadvantages, which are discussed briefly below.

## 1. Savings/ Sinking Fund

*Methodology: Put aside regular savings from after-tax corporate earnings into a cash account.*

**Advantages**

- Easy to administer
- Immediate liquidity when needed for buy-sell purposes

**Disadvantages**

- Insufficient funding is often the case - no way of knowing when death will occur
- Tax implications in cross purchase buy-sell agreements – need to dividend out funds from corporation to surviving partner/shareholder and pay personal tax to use funds for the buy-sell

## 2. Installment Payments

*Methodology: Buy out shares using instalment payments over time from the estate or heirs. The payments would be made from after-tax corporate earnings.*

**Advantages**

- No need to cut into current corporate profits to fund the agreement
- Do not need to provide all funds at once upon trigger of buyout
- Estate of deceased taxpayer can use reserves to spread out capital gains over a maximum of 5 years

**Disadvantages**

- No guarantee that corporate profits will be able to support the future buyout – possibility of insufficient or unequal bequests (albeit unintended)
- Ownership does not pass all at once to the surviving shareholder/partner, estate or heir(s) still have part interest (creates potential controlling interest issues)
- If shares carry dividend rights, the business may have to continue to pay out dividends to the estate/heir(s) until full share transition has been completed
- Tax implications in cross purchase buy-sell agreements – need to dividend out funds from corporation to surviving partner/shareholder and pay personal tax to use funds for the buy-sell

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## 3. Loan Payments

*Methodology: Buy out shares by loaning either in a lump sum or over time to provide funds for the buy-sell.*

**Advantages**

- No need to cut into current corporate profits or retained earnings to fund the agreement
- Repayment of loan is at the discretion of the business
- Exact amount required to be loaned is known at the time of disposition of the shares

**Disadvantages**

- Business may not qualify for the loan at the time when it is required
- Dilutes share value of existing shareholders until loan is repaid
- Loan interest payments put constraints on corporate cash flow
- May reduce the business's ability to make further loans that may be necessary for operations, expansion or otherwise

## 4. Insurance Funding

*Methodology: Purchase life insurance on the lives of the partners/shareholders for the value of their shares.*

**Advantages**

- Provides immediate liquidity for buyout when required
- Can be effective in both a share redemption and cross purchase agreement from a tax perspective
- Can have an increasing policy death benefit to compensate for increasing share values
- Effective and quick transition between deceased's estate and surviving shareholders
- If insurance is owned corporately, creates a balance in the Capital Dividend Account (CDA) on proceeds above the adjusted cost base of the policy – ability to pay out a tax-free deemed dividend for share buyout
- Death benefit is paid tax-free to the beneficiary of the policy (corporation or surviving shareholder)

**Disadvantages**

- Annual premium payments required out of current corporate cash flow are not tax deductible
- Death benefit of policy is only an estimate of how much is required for the future buyout – this may leave funding short of what is required
- Partner/shareholder to be insured must qualify medically for life insurance
- Funding for older or unhealthy partners/shareholders can be costly

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