Entity Buy-Sell Agreement

Do you recognize the need for a smooth transition in the event a business co-owner should die?

As a successful business owner and partner, you have developed systems to handle daily operations and attract customers. But will your business survive if one of the co-owners dies? Business owners need an agreement that allows a smooth transition in ownership and provides their families with the proceeds of the sale of their interest. The new owners can then get on with running the business instead of the business languishing in probate court or becoming dismantled by lawsuits.

What is an Entity Buy-Sell Agreement?

When a business has more than two owners, an Entity Buy-Sell Agreement is typically used to provide for an orderly buyout of a business interest. It lets business owners establish a reasonable price at which the business will purchase back their share of the business. A funded buy-sell agreement provides the money to purchase the remaining interest in the business.

How does it work?

- Each owner enters into an Entity Buy-Sell Agreement with the business.
- The business purchases a life insurance policy on the life of each owner.
- Policies are owned by the business. Premiums are paid by the business to the insurance company and are not deductible by the business.
- When an owner dies, the insurance company pays the death benefit to the business, and the proceeds are used to purchase the deceased's share at the previously agreed-upon purchase price.
- The deceased's estate sells the business interest to the business. This creates liquidity for the estate.

What role does life insurance play?

A Buy-Sell Agreement without funding is only part of the plan. The business is obligated to buy the respective interests of the owners and must have the funds to do so. Life insurance is an excellent tool for providing those funds. It may be cost-effective, easy to fund and easy to understand. Life insurance proceeds are paid when the funds are needed. If life insurance is not purchased and cash is not available to pay the family, the deceased owner's family will be paid over time and will be dependent on the success of the business for the length of the term.

Benefits of an Entity Buy-Sell Agreement funded with life insurance

A properly funded agreement may address potential problems before they arise. It can:

- Pre-determine who will purchase the business.
- Set the purchase price and terms of payment.
- Create a smooth transition for management and control.
- For federal estate tax purposes, a buy-sell arrangement can establish the value of the business.
- Guarantee financing—whenever it is needed.

- Free the deceased owner's family from business worries.
- Provide needed cash for estate expenses.
- Reduce the number of life insurance policies required (*compared to a Cross Purchase Buy-Sell Agreement*).

What about taxes?

There are several tax considerations to keep in mind with an Entity Buy-Sell Agreement funded with life insurance.

- Life insurance premiums paid by the business are not deductible.
- Death proceeds received by the business are generally received income tax-free.[1,2]
- The surviving owners' cost basis in the business is not increased for tax purposes by the amount of the payment (C Corporations).
- Generally, the estate value of the business is the value of the business as defined in the buy-sell agreement.

Ensuring the continuation of your business with a properly drafted Entity Buy-Sell Agreement may provide more than just a mechanism for transferring the business. It may save unnecessary frustration, thousands of dollars and many hours by eliminating the costs and delays of potential IRS contests, litigation and challenges from other internal and external business parties.

Tax Facts Summary
Buy-Sell Agreement Funded with Life Insurance

Policyowner	Business
Beneficiary	Business
Payor	Business
Premium payments	Not deductible
Death benefit	Not included in income*
Estate value of business interest	Fair market value of business interest as determined by IRS rules
Estate's (seller's) tax basis in business at death	Increases to fair market value at death
Surviving owner's tax basis	No "step-up" (C Corps)

[1] The Pension Protection Act of 2006 limits the death proceeds an employer can exclude from income when the proceeds are not fully applied to purchase the interest of the deceased business owner. The Act also imposes specific requirements that the employer notify the individual about the insurance, secure his/her written consent and submit annual reports to the IRS. Death benefits and tax-deferred cash accumulation may be subject to the corporate Alternative Minimum Tax (AMT).

[2] The death benefit of the life insurance policies that were transferred for value may be subject to ordinary income taxes. Estate taxes may apply. Consult your tax advisor for additional information.

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Life insurance offered through Allstate Life Insurance Company and Allstate Assurance Co., 3075 Sanders Road, Northbrook IL 60062; American Heritage Life Insurance Co., 1776 American Heritage Life Drive, Jacksonville FL 32224. In New York, life insurance offered through Allstate Life Insurance Co. of New York, Hauppauge NY.

All guarantees are based on the claims-paying ability of the issuing insurance company.

ALR1076POD 10/17