



# ***Unilateral Buy-Sell Arrangement***

*“Establish a market for your business by using a one-way buy-sell agreement with a key employee or family member.”*

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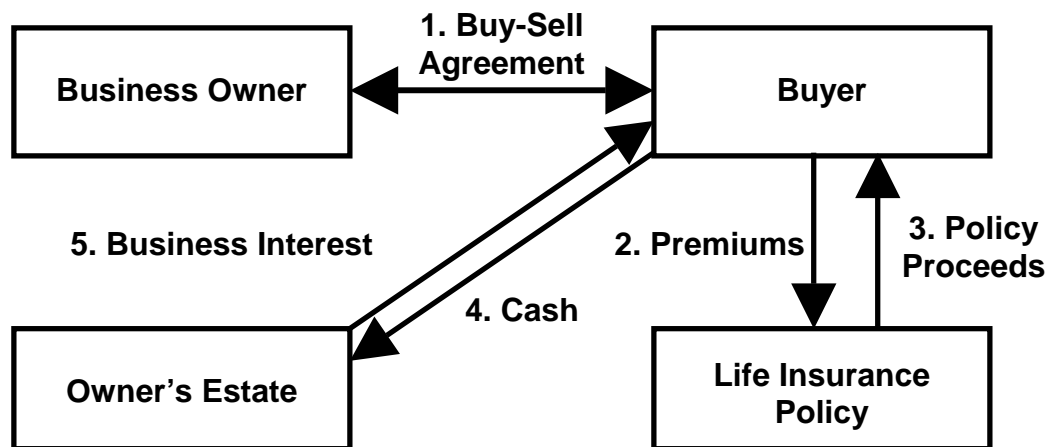
### **Do you identify with the following?**

- ◆ You are the sole owner of your business.
- ◆ You want to establish a ready market for your business interest at your death.
- ◆ You have an “heir apparent” in mind, perhaps a family member or a key employee who is capable of running the business.
- ◆ You want to establish an estate tax value for your business interest in order to reduce potential IRS disputes.
- ◆ You want to be certain that funds will be available to help with the buyout of your interest.

### **If so, you may want to consider establishing a unilateral buy-sell arrangement funded with life insurance. A unilateral buy-sell is:**

- ◆ A binding contract between you (the seller) and a willing purchaser (the buyer) providing for the transfer of a business interest under specified conditions and terms.
- ◆ An arrangement that, when funded with life insurance purchased by the buyer, helps to ensure that cash will be available to complete the buyout.

## Unilateral Buy-Sell Arrangement



1. The business owner and the buyer enter into a binding buy-sell agreement obligating the business owner's estate to sell and the buyer to purchase the owner's business interest at his/her death. Where desired, additional language can be added to the buy-sell agreement to cover a proposed lifetime sale due to disability or retirement.
2. The buyer obtains life insurance on the life of the business owner. The buyer is the owner, beneficiary, and premium payer of the policy. You should consult your legal counsel to determine whether notice and consent under IRC § 101(j) is required before the policies are issued to receive tax-favored treatment.<sup>1</sup>
3. At the death of the business owner, the buyer receives the policy proceeds.
4. The buyer uses the life insurance proceeds to fulfill his/her purchase obligation according to the terms of the buy-sell agreement.
5. The business owner's estate releases the business interest and/or assets to the buyer.

<sup>1</sup> For employer-owned life insurance policies issued after August 17, 2006, IRC § 101(j) provides that death proceeds will be subject to income tax; however, where specific employee notice and consent requirements are met and certain safe harbor exceptions apply, death proceeds can be received income tax-free. Life insurance proceeds are otherwise generally income tax-free under IRC § 101(a).

### Benefits to the Buyer:

- ◆ A funded buy-sell arrangement provides needed cash at the owner's death to help meet purchase obligations created by the agreement.
- ◆ A valued key employee or a family member is assured that their loyalty and dedication is recognized and that their role in the business will continue in the future.
- ◆ Where permanent life insurance is purchased, the policy cash values, if any, can be accessed by the policy owner for use in a lifetime purchase of the business interest.<sup>2</sup>

### Benefits to the Departing Owner or Heirs:

- ◆ The buy-sell arrangement provides a ready market for the sale of the business.
- ◆ Cash paid for the business interest is available for estate liquidity or other family needs.
- ◆ The departing owner and his or her heirs are relieved of the business responsibilities.

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<sup>2</sup> Life insurance policy cash values are accessed through withdrawals and policy loans. Loans and withdrawals cause a reduction in cash values and death benefits, may affect any guarantees against lapse, and may have tax consequences.

## Tax Considerations for the Buyer:

- ◆ Policy proceeds are generally received income tax-free under IRC § 101(a). For employer-owned contracts issued after August 17, 2006, death proceeds will be subject to income tax. However, where specific employee notice and consent requirements are met, and certain exceptions apply, death proceeds can be received income tax-free under IRC § 101(j).
- ◆ Premium payments for life insurance are not income tax-deductible.
- ◆ An employee benefit strategy such as a bonus arrangement or a split dollar arrangement may be negotiated with the business owner to help defray the buyer's personal cost of the life insurance policy.
- ◆ Policy cash value increases generally accrue income tax-deferred.
- ◆ The buyer will receive the benefit of a basis in the purchased business interest equal to the price paid.

## Tax Considerations for the Departing Owner or Heirs:

- ◆ If properly drafted, buy-sell agreements can help establish the value of the business interest for estate tax purposes.
- ◆ The sale of the business interest at death generally does not result in income taxable gains due to the step-up in basis received by the estate.<sup>3</sup> However, where "hot assets" such as unrealized receivables or appreciated inventory are sold to the purchaser, ordinary income results.
- ◆ The lifetime sale of the business will generally result in capital gains income taxation unless "hot assets" are sold.

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<sup>3</sup> Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the estate tax is repealed for the year 2010. For deaths occurring in this year only, a modified step-up in basis will be available. This is limited to a step-up of \$1.3 million in total for all beneficiaries and an additional \$3 million step-up available for property passing to a surviving spouse.

## Recommended Action Plan

1. Seek the professional advice of your attorney regarding your personal needs and objectives for the disposition of your business interest.
2. Meet with your accountant, attorney, and/or professional appraiser to determine the value of your business interest.
3. Determine the appropriate insurance solution
4. Have your attorney draft the buy-sell agreement and other appropriate documents.
5. Have the potential buyer apply for the life insurance and have the business owner (you) complete all medical and underwriting requirements.