



Corporate Cross Purchase Buy-Sell Arrangement

*“A successful business has a
business continuation plan.”*

We offer you this concept piece to help you understand how life insurance can be used to help provide funds for business continuation arrangements. This material contains references to concepts that have legal, accounting and tax implications. It is not intended as legal, accounting or tax advice. Consult your own attorney and/or tax advisor for advice regarding your particular situation. Accordingly, any information in this document cannot be used by any taxpayer for purposes of avoiding penalties under the Internal Revenue Code.

Life insurance is issued by The Prudential Insurance Company of America, Newark, NJ, and its affiliates. All are Prudential Financial companies and each is solely responsible for its own financial condition and contractual obligations. Like most insurance policies, our policies contain exclusions, limitations, reductions of benefits and terms for keeping them in force. Your licensed financial professional can provide you with costs and complete details.

***Not Insured by FDIC or any Federal Government Agency. May Lose Value.
Not a Deposit of or Guaranteed by Any Bank or Bank Affiliate.***

Prudential, Prudential Financial, the Rock logo, and the Rock Prudential logo are registered service marks of The Prudential Insurance Company of America and its affiliates.

IFS-A156563 Ed. 10/08 Exp. 12/10



Do you identify with the following?

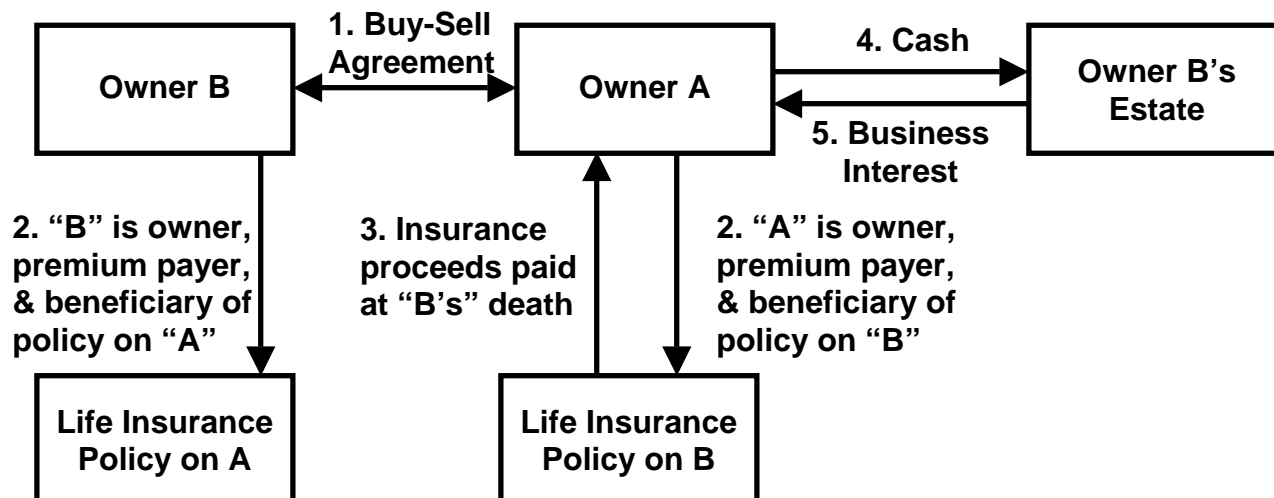
You are a business owner who:

- ◆ Has spent many long hours working in and creating value in your business and it is either one of the major assets or *the major asset* in your estate.
- ◆ Would like to create a ready market of the sale of your business interest at your death.
- ◆ Wants to see that the business remains in the hands of the family or owner group.
- ◆ Sees the need to establish an estate value for your business interest in order to reduce the potential for IRS disputes.
- ◆ Wants to be certain funds will be available to you and the other owners to help with the buyout of a deceased or departing owner's business interest.

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

- ◆ An “owner-to-owner” agreement where the surviving owner(s) – rather than the business itself – agree to buy the deceased owner's interest.
- ◆ An arrangement that, when funded with life insurance, helps ensure that cash will be available to help with the buyout.

Cross Purchase Buy-Sell Arrangement



1. All owners enter into an agreement obligating the survivors to purchase a decedent's interest and the decedent's estate to sell.
2. Each business owner purchases and is owner, premium payer, and beneficiary of a life insurance policy on the other owner(s). 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.¹
3. At the death of one of the owners, the surviving owner(s) receives the life insurance policy proceeds from the insurance company.
4. The surviving owner(s) uses the proceeds of the policy to pay the agreed upon amount, determined by the terms of the buy-sell agreement, to the deceased owner's estate.
5. The deceased owner's estate transfers the business interest to the purchasing party or parties.

¹ Life insurance death proceeds are generally received income tax-free [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 [IRC § 101(j)].

Benefits to the Purchasing Parties:

- ◆ A funded buy-sell arrangement provides needed cash to meet purchasing obligations created by the agreement.
- ◆ Where permanent policies are purchased, cash values can be accessed for use in a lifetime purchase to buy out an owner who becomes disabled or withdraws from the business.²
- ◆ A funded buy-sell arrangement minimizes the risk of the business being sold to outsiders and allows surviving owners and/or family members to retain control.
- ◆ Employees, creditors, and suppliers gain added security that the business will continue.

Benefits to the Departing Owners or Heirs:

- ◆ The cross purchase buy-sell arrangement provides a ready market for the sale of the business.
- ◆ It ensures that cash to pay estate taxes and/or to meet family needs will be available.
- ◆ If properly drafted, implemented, and maintained, the arrangement helps to establish the business value for estate tax purposes.
- ◆ The departing owner/heirs are relieved of further business responsibilities.

¹ Life insurance policy cash values are accessed through withdrawals and policy loans. Loans are at interest. 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 Remaining Owners:

- ◆ Life insurance death proceeds are generally received income tax-free under IRC § 101(a). Under some circumstances, life insurance owned in a cross purchase arrangement may be considered “employer-owned.” 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.
- ◆ Premiums paid for the life insurance are not income tax-deductible.
- ◆ Life insurance cash values generally accrue income tax-deferred.
- ◆ Where the cross purchase agreement is funded with personally owned policies, there are income tax consequences to the owners if the business provides the needed premium dollars, that is, premium dollars may be considered compensation, dividends, distributions, etc. The business may receive a tax deduction if premiums are paid out in a bonus arrangement.
- ◆ The purchasing party receives a new basis in the business interest acquired, equal to the price paid. This may provide additional tax savings if the business interest is later sold at a higher price.
- ◆ Where there are more than two owners requiring multiple policies for funding purposes, care must be taken that any management techniques employed (e.g., trusts, family limited partnerships, limited liability companies) are structured to avoid estate inclusion and transfer-for-value issues that could result in death benefit proceeds losing all or part of the exclusion from income taxation under IRC § 101(a).

Tax Considerations for the Departing Owner or Heirs:

- ◆ If properly drafted, implemented, and maintained, the arrangement helps to establish the business value for estate tax purposes.
- ◆ Where family members (parent, spouse, children) are shareholders in a closely held corporation, a cross purchase arrangement avoids the adverse income tax consequences associated with the family attribution rules of IRC § 318.

- ◆ The lifetime sale of the business interest may result in income taxation. However, the sale of the business interest at death should not result in income taxable gains due to a step-up in basis received by the estate.³

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 cross purchase agreement, corporate resolution, and other appropriate documents.
5. Apply for the life insurance to be owned individually by each stockholder and complete all medical and underwriting requirements.
6. Review the buy-sell arrangement with your licensed financial professional, attorney, and accountant on a regular basis.

³ Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the estate tax is repealed for the year 2010. For deaths occurring in that 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 for property passing to a surviving spouse.