Columbus Life Insurance Company

A member of Western & Southern Financial Group

BUSINESS CONTINUATION PLANNING

Buy-Sell Agreements

Protecting the Survival of Your Business

Will your business survive your… Disability? Retirement? Death?

The healthiest, youngest, most energetic business owner will at some moment in time either sell his or her business or become disabled, retire or die while owning the business.

Help protect the survival of your business.

BUSINESS CONTINUATION PLANNING

- Will your business continue to thrive in your absence?
- Are there family members, other owners or key employees who could continue to successfully run the business without your guidance?
- Will your family be taken care of financially without your business continuing?

WHAT DOES THE FUTURE HOLD FOR YOUR BUSINESS?

Having a robust, documented and communicated business succession plan in place can be the difference between success and failure for small and family-owned businesses.

As an owner of a closely held business, only **three choices** exist for the disposition of your business interest:

1. Sell to co-owners, family members or outside third parties.
2. Liquidate the business.
3. Retain the business within the family.

This decision-making process may be a difficult process. You have great investments in your business: physical, financial and emotional investments. Any success the business has experienced came as a result of hard work, perseverance and an ability to take risks.

It is these traits that will help your business to continue operating successfully until the inconceivable happens. Then, the effort you have put into your business continuation planning will factor into its future.

SELLING THE BUSINESS

Where the appropriate plan of action would be to sell the business interest if you should withdraw, retire, become disabled or die prematurely, establishing a formal plan for the sale of your business may be one of the most important actions you ever take with respect to your business. A funded buy-sell agreement is an available option in this process.

Procrastination may be costly. Failing to effectuate a plan may jeopardize the business's continued success.

A BUY-SELL AGREEMENT:

- Guarantees a buyer.
- Establishes a fair price.
- Helps set the terms of the purchase and identifies the events that trigger a buyout.
- Helps provide a smooth transfer of the business.
- Provides cash to you in the event of a disability, withdrawal or retirement, and liquidity to your estate.
- Helps avoid conflicts.
- Helps with the continuation of the business.

How a Buy-Sell Agreement Works

A buy-sell agreement is a contract that helps in the continuation of the business by obligating the company or co-owners to buy, and obligating you or your estate to sell, the business interest at the occurrence of specified events such as death, disability, withdrawal or retirement.

Drafted properly, a buy-sell agreement will help set the value of the business for federal estate tax purposes and may reduce the chance of valuation disputes with the IRS.

Funding the Buy-Sell Agreement

The terms of the buy-sell agreement should specify how the purchasing party will pay for the business interest.

Options include:

- Cash payments from savings.
- Borrowing.
- Installment sale.
- Insurance proceeds.

Savings Fund

Since death and disability, and occasionally an owner's withdrawal, can occur without notice, planning to save for these events can be impractical. Attempts to save for these events cannot assure that sufficient funds will be available when needed.

Borrowing

The loss of an owner of a closely held business can have a devastating impact on the stability and future success of the business. At the death or disability of an owner—when cash is needed most—banks and loan institutions may be reluctant to lend money to the company or co-owners. Credit standings, ability to borrow, and the cost of borrowing in the future may be unknown, making borrowing impractical and possibly expensive.

Life Insurance Funding

Insurance creates a cost-effective method of providing for the death or disability of an owner.

- Life insurance produces an immediate death benefit that is generally received income-tax-free at the precise time it is needed.
- A permanent (i.e., that which provides a cash value) life insurance policy may serve double duty, providing a death benefit and also a cash value fund that accumulates on an income tax-deferred basis and can be accessed via loans and/or withdrawals.[1]
- Policy cash value, if any, may be available to provide some of the funds necessary to purchase an owner's interest at retirement or withdrawal. *(Death benefit amount will be reduced if cash value is withdrawn from policy.)*

Life insurance can transfer the risk of premature death from the co-owners or business to the insurance company.

1 Loans will accrue interest. Loans and withdrawals may generate an income tax liability, reduce the Account Value and the Death Benefit, and may cause the policy to lapse. Sufficient premium and account value are necessary to cover insurance costs and charges. The policy may be issued as a Modified Endowment Contract (MEC) for tax purposes. Any withdrawals or surrenders could result in a taxable event

To ensure the generally income-tax-free nature of the death benefit for certain business-owned life insurance policies, it is necessary to comply with Internal Revenue Code Section 101(j) for policies issued after Aug. 17, 2006.

These rules require that the insured/employee receive notice of, and consent to, the life insurance policy prior to its issue where the business/employer is the owner and beneficiary of the policy and will continue to be the beneficiary after the insured leaves the business.

For more information on these rules and additional reporting requirements, contact your tax advisor.

Installment Sales

Installment sales are often part of a buy-sell agreement and may be used to pay all or some of the purchase price. Installment sales may require payment of principal and interest from current earnings and force the departing owner or heirs to possibly rely upon the future success of the business in order to receive payments.

Used alone, installment sales may place a substantial burden on all the parties. Used in conjunction with insurance funding, installment sale provisions provide a method of completing the purchase when existing life or disability buyout insurance may be inadequate.

ADVANTAGES OF LIFE INSURANCE

- Financing is established from the beginning.
- Proceeds may be free from income tax.
- Cash values can be used for a buyout due to retirement or disability. *(Death benefit amount will be reduced if cash value is withdrawn from policy.)*
- Generally is economical.

BUY-SELL AGREEMENT CASE STUDY

The Problem

John and Mary, both in their 50s, are successful owners of a family nursery. They have two children. Jennifer, age 32, is a social worker and has no interest in working for the family business. Jacob, 28, currently works full-time in the nursery and eventually would like to own the store.

The unexpected passing of John's brother in a tragic car accident has raised their concern about what would happen to the nursery if something should happen to both of them.

- John and Mary want to see both of their children treated "equally" and they want the business to continue without interruption if tragedy should occur.
- They currently have an estate plan that simply leaves everything to the surviving spouse if something should happen to either of them and divides their assets equally between their two children at the second death or in the event of a simultaneous death.
- An independent appraiser has recently valued the business at $1.2 million. John and Mary agree that this is a fair valuation.

A Possible Solution

To help keep the business running without interruption in the event of their death, they decide to execute a buy-sell agreement. This agreement also addresses what should happen upon either of them becoming disabled or withdrawing from management after age 65.

- Under the agreement, Jacob must purchase John's shares in the event of his death and Mary's shares in the event of her death. He also must purchase each of their shares in 10 annual installment amounts upon their disability or withdrawal.
- Jacob is going to purchase life insurance policies on John and Mary for $600,000 each. The business is going to pay the premiums and double bonus that amount to Jacob as W-2 income.
- John and Mary are going to change their estate plan to reflect that the business will have been sold and that any remaining cash is to be divided equally between Jennifer and Jacob.
- Recognizing that the nursery was their major asset and they did help Jacob acquire the nursery, they decide to purchase a second-to-die policy for $250,000 and name Jennifer as the sole beneficiary. John and Mary are comfortable that they are leaving an equitable legacy for both of their children.

THE PROPERLY FUNDED BUY-SELL AGREEMENT:

- Helps provide for the transfer of the business to Jacob.
- Helps avoid business disputes between shareholders who are active in the business and those who are not.
- Helps set the value of the business for federal estate tax purposes.
- Helps provide continuity in management, which helps provide stability for customers, staff and creditors.

Your financial representative can help create the programs that are best for your business. Call today to learn more.

ABOUT COLUMBUS LIFE

Columbus Life is a highly rated life insurance company providing personal life, retirement and business planning solutions through a nationwide network of independent representatives. Financial strength is our enduring legacy and has been a cornerstone of our success since our 1906 founding as Columbus Mutual. Find out more about our financial strength and distinguished history at ColumbusLife.com.

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