Exit Planning

Buy-Sell Agreement Comparison

A key component of an exit strategy is a buy-sell agreement. The agreement creates a market for the business when a co-owner dies, becomes disabled or leaves the business. A buy-sell agreement, properly structured and adequately funded with life and disability insurance from the Principal Financial Group®, can help provide a solid landing platform for your exit plan — and the people who depend on the future of your business.

Protection benefits of buy-sell agreements

- **Family** – You and your family can be protected by obligating co-owners to buy your interest in the business for a set price and providing them the funding to do so if you die, become disabled or leave the business.
- **Co-owner** – Co-owners gain protection by providing them the opportunity and funding to purchase the business interest of a deceased, disabled or departing owner.
- **Continuation** – Minimize discord among owners by setting the price and terms of a sale when an owner leaves the business.
- **Business** – Protect the business by preventing unwanted transfers to parties that might be unqualified or contentious, by limiting transfers of an interest in the business except under limited circumstances.
- **Estate** – Fix the value of your business interest for estate tax purposes if the price meets IRS guidelines at the time the agreement was signed.

Secure the future

For more than a century, The Principal® has helped businesses and individuals achieve their personal and business objectives. You can count on our steadfast commitment to provide quality, reasonably-priced financial products and services that help both businesses and individuals plan a more secure future.

FOR MORE INFORMATION

Please contact your local financial professional.
## Buy-Sell options

The basic buy-sell agreement types are Cross Purchase, Entity Purchase and Wait and See. It is helpful to understand the basic features of each type.

### Cross Purchase
- **How it works**
  1. Owners enter into an agreement obligating the remaining owner(s) to purchase a departing owner’s interest.
  2. Each owner may own, pay premiums on and be the beneficiary of an insurance policy(ies) on each other. Either life insurance, disability insurance or both can be used.
  3. Upon a triggering event, policy values or death benefits owned by the remaining owner(s) may be used to purchase the interest of the departing owner.
  4. The departing owner’s interest is transferred to the remaining owner.

- **Cross Purchase Considerations**
  - Remaining owners receive a basis increase equal to the purchase price paid to the departing owner. This helps reduce taxes on a subsequent sale of the business.
  - If three or more business owners are involved, multiple policies per owner are required which may become cumbersome, and another form of buy-sell, such as entity purchase, may be a solution.

### Entity Purchase
- **How it works**
  1. Business enters into an entity purchase agreement with each owner obligating the business to purchase an owner’s interest in the business after a triggering event. Each owner and/or owner’s estate agrees to sell the departing owner’s interest to the business.
  2. The business purchases insurance protection on each owner. The business is the policy owner, the premium payer and beneficiary of each policy.
  3. At a triggering event, the business may access cash value or collect death proceeds from the policy(ies).
  4. The business then pays an amount, determined by the terms of the entity purchase agreement, to the owner or owner’s estate. The owner or the owner’s estate transfers the business interest to the business.

- **Entity Purchase Considerations**
  - Only one policy per owner required, regardless of how many owners are involved.
  - The business is the purchaser, thus remaining owners may not receive increased basis.
  - This could result in higher taxes on a subsequent sale of the business.
  - Depending on financial circumstances, creditors may be able to prevent the entity from purchasing the interests of owners.
  - Where family members will continue as owners, entity redemptions can receive some basis increase which must be reviewed with the client’s advisor.

### Wait and See
- **How it works**
  1. Both the owners and the business enter into an agreement for the purchase of a deceased or departing owner’s interest that obligates the departing owner or decedent’s estate to sell.
  2. The business purchases insurance on each shareholder using an entity purchase approach.
  3. At the departure of owner B, the business may access cash value or (depending on the triggering event) receive death proceeds from the policy(ies) on owner B.
  4. The business is given the option to purchase the stock from owner B or owner B’s estate within a certain period stated in the buy-sell agreement. The business can purchase all or a portion of the departing owner’s interest.
  5. If the business chooses not to fully exercise its option, the remaining owner(s) is given an option to purchase all or some of the remaining shares within a stated period of time.

- **Wait and See Buy-Sell Considerations**
  - Wait and see gives remaining owners the flexibility to select the most favorable structure for the purchase of the departing owner’s business interest.
  - The added flexibility of a wait and see may create additional tax complications which must be reviewed with the client’s advisor.

### Table: Cross Purchase

<table>
<thead>
<tr>
<th>Plan</th>
<th>Description</th>
<th>Insurance Arrangement</th>
<th>Income Tax Aspects</th>
<th>Estate Tax Aspect</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cross Purchase</strong></td>
<td>Co-owners purchase departing owner’s business interest</td>
<td>Each owner pays premium on policies he or she owns</td>
<td>Each owner is beneficiary of policies he or she owns</td>
<td>Ownership of other owner’s business interest is not a taxable event</td>
</tr>
<tr>
<td><strong>Entity Purchase</strong></td>
<td>Business purchases departing owner’s business interest</td>
<td>Business</td>
<td>Business</td>
<td>Premises not deductible, Proceeds received tax free</td>
</tr>
<tr>
<td><strong>Wait and See</strong></td>
<td>Purchase of departing owner’s business interest by either remaining owner(s) or business</td>
<td>Remaining owner(s) or business</td>
<td>Remaining owner(s) or business</td>
<td>Depends on the previously mentioned owner and beneficiary arrangements</td>
</tr>
</tbody>
</table>

1. The tax deduction for interest expense on general borrowing may be reduced if the business owns life insurance contracts issued after June 8, 1997, on the lives of certain insureds.
2. Proceeds may be subject to corporate alternative minimum tax. Generally, the alternative minimum tax applies to corporations with average annual gross receipts in excess of $7.5 million for the prior three-year period.
3. If purchase price received is equal to value of business interest at death, there will be no income tax payable upon sale. Under the current law, basis step up at death is replaced by a modified carryover basis rule in 2010 only.
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