Buy-Sell Cross Purchase

Essentials 2018

In a cross-purchase plan, company owners agree in advance to buy the interest of a withdrawing/deceased owner while the withdrawing/deceased owner agrees to sell his or her ownership interests to the remaining owners. A properly structured cross purchase plan makes the entity a better credit risk by increasing the probability of the business continuing past an owner's death.

Buy/Sell Planning is a Critical Element of Any Successful Business

All businesses can benefit from buy-sell planning – sole proprietorship, C Corporation, S Corporation, Partnerships, LLCs, etc.

- Provides a definite market for transferring the ownership interest. In a cross-purchase buy-sell, the co-owners must purchase the interest
- Specifies a set or determinable price. This price may also set the value used for estate tax calculation
- Provides some or all of the funds necessary to execute the agreement – when properly funded with life insurance
- Maintains "closeness" of the business by restricting and planning who/what can receive the business interests
- Provides liquidity to pay estate taxes (due to nine months from date of death)

How Cross-Purchase Works

1. At an owner's death, disability, or departure, the surviving/remaining owners agree to purchase the business interest – this is documented in a formal agreement between/among the owners.
2. Each business owner applies for (and is beneficiary of) a life insurance policy on every other owner and will pay the policy premiums.
3. At death, each surviving owner receives the policy death proceeds.
4. If departure is for reasons other than death (i.e. disability) the policy's cash values can be accessed to partially or totally fund the purchase.
5. Each surviving owner purchases the agreed business interest from the decedent's estate (e.g. if there is only one surviving shareholder, s/he purchases all of the business interest from the estate).

Why Life Insurance

- Cash value inside a policy grows tax-free.
- Death proceeds are received income tax-free and received at just the right time to fulfill the agreement.
- Individually owned policies are generally not subject to the business' creditors.

Considerations

- Business owners use personal funds to pay premiums on the policy they own. A split-dollar (loan arrangement or employer endorsement) arrangement can be implemented to assist in paying premiums.
- Possible disproportional premium payments – the younger/healthier owners will pay more in premiums to insure the older/less-healthy owners.
- Policies are potentially subject to the individual's creditors (varies by state law).

- Administratively complex – the more business owners the more policies that must be purchased and maintained. For example: if there are three owners, each owner will own and maintain two policies (six policies total) – if there are six owners, each owner will own and maintain five policies (30 policies total).

Essentially

Estate's non-liquid asset (i.e. the business interest) is sold to the remaining owners at an agreed upon price (little or no gain should be taxable due to step-up in basis at date of death). The business interest passes to those intended to receive that interest. Surviving owners receive basis in the acquired interest equal to the price paid (step-up in basis).