A cross purchase buy-sell for businesses with multiple owners

case study

If your clients' business is owned by multiple people, but they want the benefits of a cross purchase buy-sell strategy, try a trusteed cross purchase instead.

How does this strategy work?

In a cross purchase buy-sell agreement, each business owner buys a life insurance policy on the other owner(s). With multiple owners, this can get very complex and complicated. Instead, try a trusteed cross purchase buy-sell, in which a third party (acting as trustee) takes care of the buy-sell arrangement. Each owner transfers his or her share of the business to the trust, then the trustee purchases a single life insurance policy on each owner. The trust is the owner and beneficiary of the policies.

When one of the owners passes away, the life insurance benefit goes to the trustee, who in turn pays the deceased owner's estate for their business interest. Then the trustee allocates the deceased owner's shares to the surviving owners so they each have an equal amount.

Client Need

- Business continuation
- Potential tax-advantages
- Generational business transfer

Benefits of this strategy:

- Fewer policies are needed, compared to a traditional cross purchase buy-sell arrangement.
- The policies and cash values are generally not subject to the business's creditors.
- The surviving shareholders will receive full basis credit for the purchase of the stock. This will reduce the capital gains tax when the surviving owners eventually sell the business.

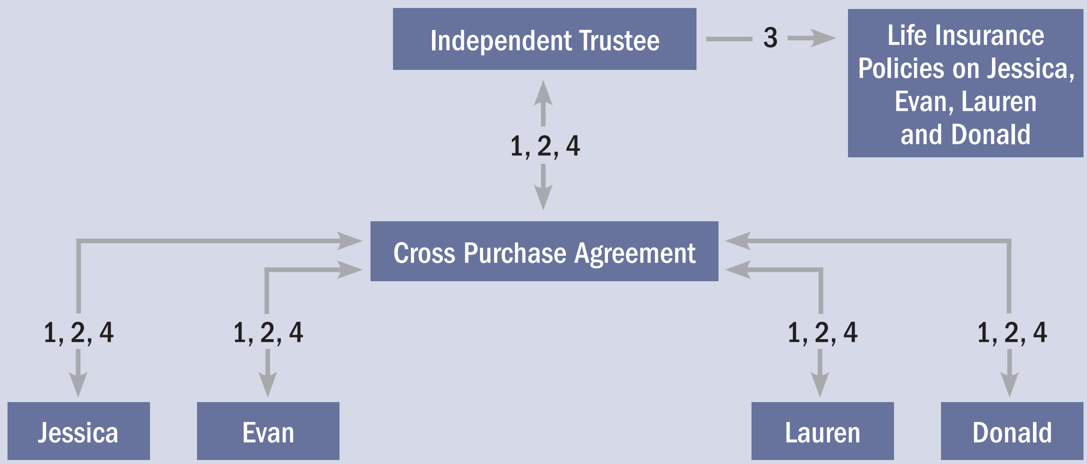
Considerations to keep in mind:

- The owners will need to use their own after-tax funds to pay for the life insurance policies, and premiums are not deductible.
- If the owners are different ages or would be rated differently, one may have to pay a disproportionate amount of premiums.
- The company cannot record the cash value in the policy as a business asset.

Strategy in action

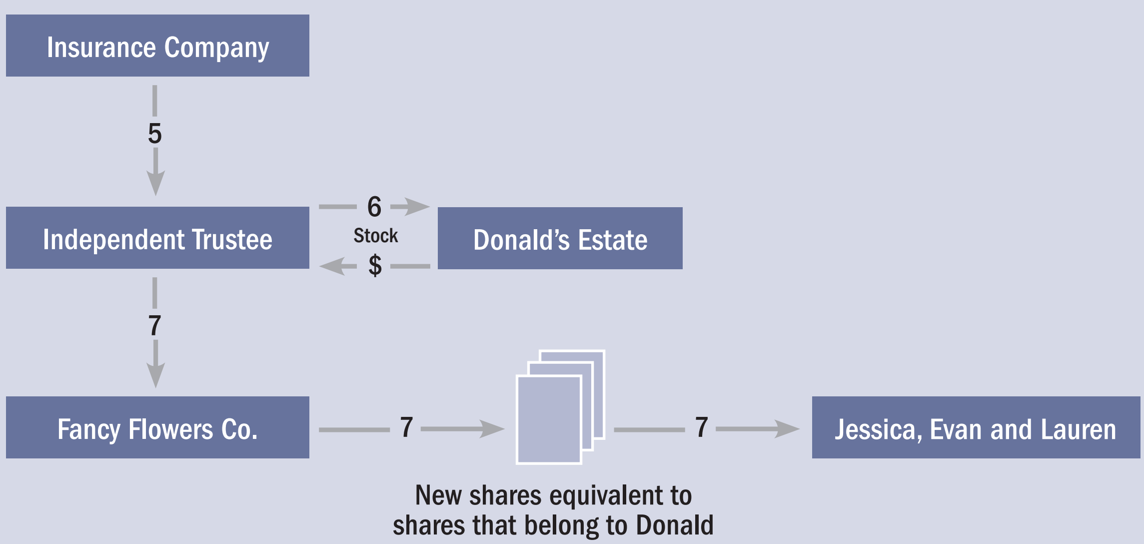
- Jessica, Evan, Lauren and Donald own a flower shop called Fancy Flowers. Here's how the strategy would work.

Establishing and Funding the Plan



1. Jessica, Evan, Lauren and Donald each sign a cross purchase agreement with an independent trustee.
2. Each endorses their stock certificates in blank and delivers them to the trustee.
3. Each agrees to allow the trustee to take out an insurance policy on his or her life.
4. Each periodically contributes funds to allow the trustee to pay the premiums on the policies.

At Death or Other Triggering Event



5. Assuming Donald dies, the insurance company pays the death benefit to the trustee.
6. The trustee pays Donald's estate in exchange for his business interest.
7. The trustee then sees that the Fancy Flowers Company issues new shares to the surviving owners (Jessica, Evan and Lauren), equal to the shares that belonged to Donald.

Prospective client

- Business with three or more owners.
- Wants to ensure that the business will continue with the surviving owners if one owner passes away.
- Wants to keep extra cash value off the books and not subject to the creditors of the business.

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