



## 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. Adequately funded with life and disability buy-out insurance from Principal Life Insurance Company, a properly structured buy-sell agreement can help provide exit planning protection.

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 or become disabled.
- **Co-owner** – Co-owners gain protection by providing them the opportunity and funding to purchase the business interest of a deceased or disabled 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.

A carefully constructed exit strategy can create a solid landing platform for the future of your business – and the people who depend on it.

## Secure the future

For more than a century, Principal Life 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 Principal Life representative.

# 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.

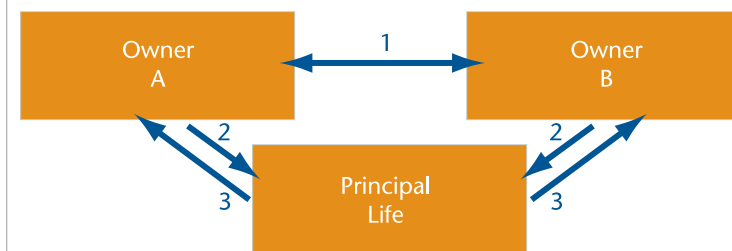
Plan	Description	Insurance Arrangement			Income Tax Aspects				Estate Tax Aspect
		Premium Payor	Owner	Beneficiary	Business	Purchasing Owner	Seller Upon Death	Seller Upon Disability	
<b>Cross Purchase</b>	Co-owners purchase departing owner's business interest	Each owner pays premium on policies he or she owns	Each owner owns policy on life of each other owner	Each owner is beneficiary of policies he/she owns	Not a party to the agreement	<ul style="list-style-type: none"> <li>• Premiums not deductible</li> <li>• Proceeds received tax-free</li> <li>• Basis increased by amount paid to deceased's family</li> </ul>	Purchase price received generally doesn't cause taxable event <sup>3</sup>	Seller recognizes capital gain to the extent proceeds exceed basis	Value of business interest and cash value of policies on other owners included in gross estate
<b>Entity Purchase</b>	Business purchases departing owner's business interest	Business	Business <sup>1</sup>	Business	<ul style="list-style-type: none"> <li>• Premiums not deductible</li> <li>• Proceeds received tax-free<sup>2</sup></li> </ul>	<ul style="list-style-type: none"> <li>• C corporations – no basis increase to surviving owners</li> <li>• S corporations and other pass-through entities – with planning, surviving owners may be able to obtain some basis increase</li> </ul>	Purchase price received generally doesn't cause taxable event <sup>3</sup>	Seller recognizes capital gain to the extent proceeds exceed basis	Value of a business interest included in gross estate
<b>Wait and See</b>	Purchase of departing owner's business interest by either remaining owner(s) or business	Either	Either (most often owners)	Either (most often owners)	Depends on the previously mentioned owner and beneficiary arrangements	Depends on the identity of purchasing owner made at time of death	Depends on the identity of purchasing owner made at time of death <sup>2</sup>	Seller recognizes capital gain to the extent proceeds exceed basis	Value of business interest and possibly value of policies on other owners depending on ownership structure

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> 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.

## Cross Purchase Buy-Sell



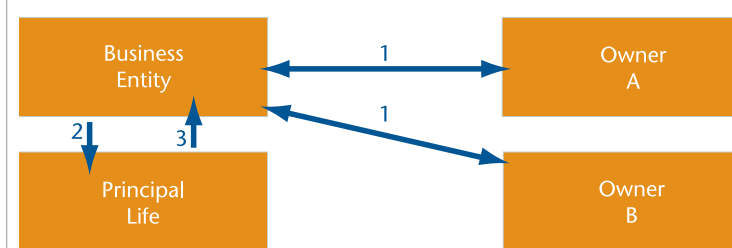
### How it works

1. Buy-Sell agreement is established.
2. Owner A owns and pays premium for policy on owner B. Owner B owns and pays premium for policy on owner A.
3. Income tax-free death benefit when owner B dies. Income tax-free death benefit when owner A dies.

### Cross Purchase considerations

- Business owners enter an agreement between themselves. The business is not party to the agreement.
- Upon the death or disability of an owner, the remaining owner(s) are obligated by the agreement to purchase the business interest of the deceased or disabled owner at a price determined under the agreement. Owner(s) may fund the purchase with insurance proceeds.
- 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.

## Entity Purchase Buy-Sell



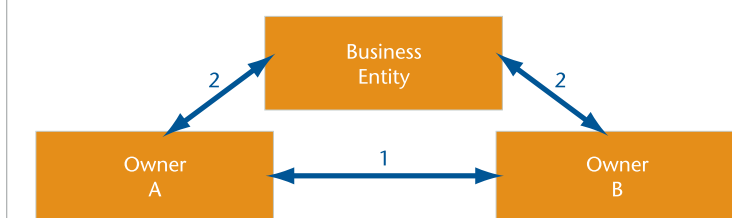
### How it works

1. Buy-Sell agreement is established between owner A and the business entity and owner B and the business entity.
2. Business pays premium on policies owned on each owner's life.
3. Income tax free death benefit paid to the business.

### Entity Purchase considerations

- Business owners enter an agreement with the business.
- 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 negative income tax treatment and should be considered carefully.
- Under Section 101(j) of the Pension Protection Act, the death proceeds of an employer-owned life insurance policy must meet certain requirements to qualify for tax-free status.

## Wait and See Buy-Sell



### How it works

1. Owners enter an agreement between themselves and the business.
2. At the death or disability of an owner, the owner's interest will be purchased by either co-owners or the business.

### Wait and See Buy-Sell Considerations

- Owners enter an agreement between themselves and the business.
- A Wait and See Buy-Sell gives remaining owners the flexibility to select the most favorable structure for the purchase of the departing owner's business interest. This added flexibility creates additional tax complications which must be reviewed with the client's tax advisor.
- With a Wait and See agreement, the facts of each business case should influence the initial decision of whether the individual owner or the business will own the life insurance policy.
- Under Section 101(j) of the Pension Protection Act, the death proceeds of an employer-owned life insurance policy must meet certain requirements to qualify for tax-free status.



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Principal Life Insurance Company, Des Moines, Iowa 50392-0001, [www.principal.com](http://www.principal.com)

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