



S-Corp Redemption Buy-Sell

- ☒ Buy/sell planning is a critical element of any successful business.
- ☒ It provides a definite market for transferring the ownership interest. The co-owners or business entity must purchase the interest.
- ☒ It specifies a set or determinable price. This price may also set the value used for estate tax calculation.
- ☒ It provides some or all of the funds necessary to execute the agreement – when properly funded with life insurance.
- ☒ It maintains “closeness” of the business by restricting and planning who/what can receive the business interests.
- ☒ It provides liquidity to pay estate taxes (due 9 months from date of death).
- ☒ It makes the entity a better credit risk because of the probability of business continuing past an owner’s death.
- ☒ All businesses can benefit from buy-sell planning – sole proprietorship, C Corporation, S Corporation, Partnerships, LLCs, etc

How S corporation stock redemption works: (for cash basis – NOT accrual basis - S Corporations):

- At an owner’s death, disability or departure, the corporation agrees to purchase the business interest from the owner– this is documented in a formal agreement between the corporation and the owners.
- The corporation applies for (and is beneficiary of) a life insurance policy on each owner.
- At death, the corporation redeems the deceased shareholder’s interest for a promissory note. This eliminates the deceased shareholder’s estate as a shareholder of the S corporation.
- The corporation then elects a short tax year under IRC 1377 (a)(2).
- The corporation then receives the policy’s death benefit after the start of the new tax year. Receipt of policy death benefit increases the basis in current shareholder’s stock. “Current shareholder” includes the surviving shareholders and does not include the deceased shareholder or his/her estate.
- The corporation pays off the note with the policy death benefit.

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The preceding summary is intended to be a general discussion of the topic presented, and is based on our current understanding of applicable tax laws, regulations and rulings. In actual practice, the transaction discussed may be more complex and will require the attention and expertise of professional advisors. In no way should this summary be construed to constitute tax or legal advice. **For agent use only.**

Results:

- Estate's non-liquid asset (i.e. the business interest) is sold to the corporation at an agreed upon price (little or no gain should be taxable due to step-up in basis at date of death – assumes death in other than 2010 when there is a modified carryover basis rule in effect).
- The business interest does not pass to any unintended parties.
- A minimal amount of administration is required since only one policy per owner needs to be purchased and maintained.
- Corporation provides premium payments thus avoiding any inequity/unfairness associated with individual premium payments with cross-purchase planning.
- The policy's cash value is an asset on the business' balance sheet offsetting the redemption obligation.
- The surviving shareholders receive a step-up in basis according to their ownership interest.

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.

In order for the death proceeds to receive income-tax free treatment, the Pension Protection Act of 2006 requires two items:

- The consent and notice requirements are met; and
- The insured is a key person or the ultimate payee (not beneficiary) is:
 - A member of the insured's family;
 - The designated beneficiary (other than employer);
 - A trust established for the benefit of any such person; or
 - The insured's estate.

Disadvantages:

- Policy cash value is potentially subject to corporation's creditors.
- Premium payments are not deductible.

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