Agent and Advisor Guide to
Advanced Markets Concepts

AVIVA

Stock 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 stock redemption works:

1. 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.
2. The corporation applies for (and is beneficiary of) a life insurance policy on each owner.
3. At death, the corporation receives the policy death proceeds.

a. 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.

4. The corporation purchases (redeems) the agreed business interest from the decedent's estate.

Results:

- Estate's nonliquid 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.

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Why life insurance:

- Cash value inside a policy grows tax-free subject to potential AMT.
- Death proceeds are received income-tax free (subject to potential AMT) 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 are met:
- The notice and consent 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.
- Remaining business owners do not received a basis increase in their ownership interest.
- Possible dividend treatment in family situations. In a family-owned corporation, the redemption may be treated as a dividend instead of a capital gain.

S corporation remaining owners may be able to receive a stepped-up basis with proper redemption planning.