A resource for business owners

Guardian®

Help protect the future of your business and your loved ones

Discover the difference an Entity Purchase Buy-Sell Agreement can make

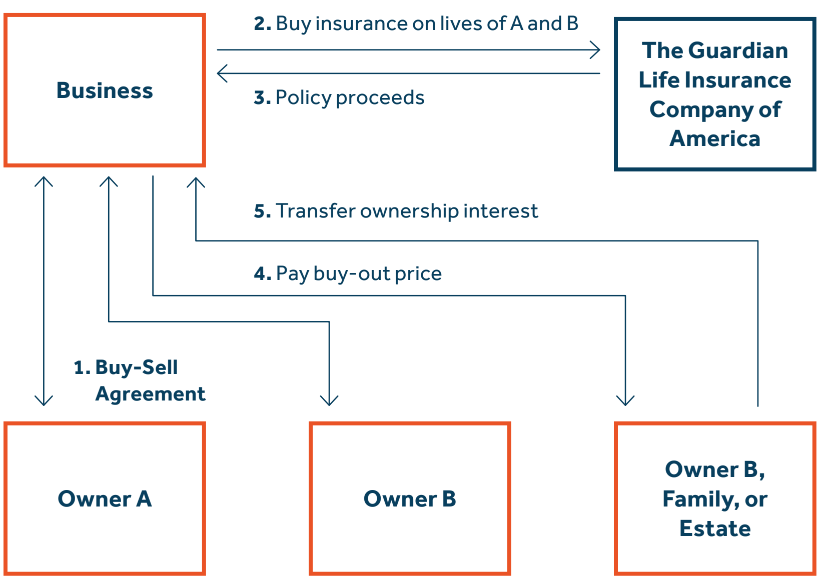
Successful business owners have so much to focus on when it comes to running their company that it may be hard to find time to plan for the future. But the right planning could be essential for the continuity of your company. If you or one of your co-owners were to depart from your business due to death, disability, or retirement, business continuation planning could help to ensure a smooth transition — one where your company carries on as usual, despite the change in ownership.

Business continuation planning will enable you to put a solid succession plan in place. And one strategy you may wish to consider implementing is the Entity Purchase Buy-Sell Arrangement.

What is an Entity Purchase Buy-Sell Arrangement?

In an Entity Purchase, the Buy-Sell Agreement is between the business and the individual owners. The business will be the buyer of a deceased/departing owner's business interest. Where the business is in the form of a corporation, the Entity Purchase Buy-Sell Arrangement is known as a Stock Redemption Agreement. One advantage to this method is that the business controls the administration and maintenance of the arrangement. And, as with other business continuation planning strategies, the Entity Purchase Buy-Sell Arrangement can be funded with permanent life insurance.

The illustration below shows how an Entity Purchase Buy-Sell Arrangement works when funded with life insurance.[1]



How it works

1. The business enters into a Stock Redemption Agreement with each shareholder, obligating the business to purchase the deceased or disabled shareholder's interest in the business and obligating the disabled shareholder or deceased shareholder's estate to sell.
2. The business purchases life and disability insurance on the life of each shareholder equal to at least the value of the shareholder's ownership interest. The business is the owner, premium payer, and beneficiary of each policy.
3. The business receives the insurance policy proceeds from the insurance company.
4. The business pays the disabled shareholder or deceased shareholder's estate the buy-out price, as agreed to under the Stock Redemption Agreement.
5. The shareholder or estate transfers the shares to the corporation. The remaining shareholders now own all the issued and outstanding stock of the business.

Advantages of the Entity Purchase Arrangement:

- The co-owners, employees, creditors, and suppliers can feel more protected knowing a succession plan is in place.
- The Stock Redemption Agreement can provide a ready market for the sale of your business.
- It can help establish the business value for estate tax purposes.
- The agreement provides for a mechanism to determine the fair value of each stockholder's business interest.

The importance of proper funding

It is possible to create an Entity Purchase Buy-Sell Arrangement without life insurance, but payment would likely have to come from business cash flow, cash reserves, by borrowing funds, or from an installment sale. However, the entity's purchase obligation imposes a liability on the company that may need to be reflected on the company's books and may impact the company's financials.

For instance, the liability may negatively impact the company's financial ratios, such as debt-to-equity and cash ratios, that banks and lenders may review. Further, outstanding bank loans may be immediately callable upon a business owner's death, putting even more strain on the company's financials and cash flow. So, adequately funding the agreement is a crucial step to a successful plan to make sure sufficient liquidity is there when you need it.

When the arrangement is funded with life insurance:

- It helps ensure that the cash is available to help pay estate taxes or it may be used for other purposes.
- The policy's cash values are reflected on the balance sheet and available for business needs.[2, 3]
- The cash is available immediately, without delay or the losses sometimes caused by hurried liquidation sales.[4]
- The insurance funding provides the necessary cash to execute on the buyout without having to rely upon personal resources, credit, or cash flow.

One important note:

When an Entity Purchase Buy-Sell Arrangement is executed, in a regular corporation, the remaining shareholder(s) do not get an increase in basis because the corporation, not the remaining shareholder, is purchasing the deceased or disabled shareholder's shares.

When it's time to "get down to business" about helping to ensure your company can endure, no matter what the future may hold, be sure to learn about the important role an Entity Purchase Buy-Sell Arrangement can play.

Learn more today.

Contact a Guardian financial professional to discover if an Entity Purchase Buy-Sell Arrangement is right for your business.

The Guardian Life Insurance Company of America

guardianlife.com

New York, NY

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1 Disability provisions, including disability buy-out insurance, should also be considered to fund the buy-sell arrangement in the event that it is triggered by the disability of one of the participating owners.

2 Cash values in a whole life policy may accumulate from dividends. Dividends are not guaranteed. They are declared annually by Guardian's Board of Directors.

3 Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal may also be subject to a 10% federal tax penalty.

4 In order to obtain income tax-free treatment of the proceeds, the business's tax and legal advisors should ensure compliance with IRC Section 101(j). Section 101(j) lists several requirements, including the insured meeting certain qualifications, and written notice and consent procedures. Ongoing compliance requires the annual filing of IRC Form 8925 with the business's tax return. For further information on the "employer-owned life insurance" rules of Section 101(j), please ask your Guardian financial professional for our informational memo titled "IRS Notice 2009-48: EOLI and IRC 101(j) Notice and Consent Rules."