Protect the Future of Your Business

Learn More About
Buy-Sell Agreements

Mutual of Omaha

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You've worked hard to build your business. How can you ensure that your business lasts well into the future?

A buy-sell agreement is one way to protect your business if you or one of your business partners dies or leaves the business. A properly drafted and funded buy-sell agreement can protect you and the people you care about in different ways.

Family

With your co-owners committed to buying your interest from your family at a set price, your family knows they will have money to replace your income.

Co-Owner

Co-owners know they will have the funds to buy each other out and minimize business disruption.

Business Continuation

With a set price and adequate funding in place, conflicts between co-owners are minimized.

Business Integrity

The agreement can prevent transfer of business ownership to people who might not be qualified or who you may rather not have as partners.

Types of Buy-Sell Agreements

There are many types of buy-sell agreements. Let's take a look at some of the agreements and the opportunities each type may present for you.

Cross Purchase Buy-Sell

This may be the simplest form of buy-sell agreement funding.

How it works:

1. Each business owner owns and is beneficiary of a life insurance policy covering each other business owner.
2. The death benefit is income tax free to the beneficiary.
3. At the business owner's death, the surviving owners use the death benefit to buy the ownership interest of the deceased owner under the terms of their written buy-sell agreement. Their cost basis in the newly purchased shares is typically the value they pay for those shares.
4. The heirs of the deceased business owner transfer the ownership in exchange for the payment. They receive a step up in their cost basis to the value of the ownership interest on the date the deceased owner died. As a result, the sale of the business interest is usually income and capital gains tax free to the heirs.

Entity Purchase Buy-Sell (Stock Redemption)

This can balance the costs between the owners if there is a significant age or health difference between them, and work well with multiple owners.

How it works:

1. The entity (the company) owns and is beneficiary on one life insurance policy insuring each owner.
2. At the death of an owner, the death benefit is paid to the company income tax free (assuming compliance with Tax Code Section 101(j)).
3. Under the terms of the written buy-sell agreement, the company pays the estate or heirs of the deceased owner, and that owner's interest is redeemed by the company.
4. The remaining owners' interests increase in value, since they are now a higher percentage of the entire company.

Wait and See Buy-Sell

This gives the owners the flexibility to choose the form that works best at the time the agreement is triggered.

How it works:

1. Each business owner owns and is beneficiary of a life insurance policy on each other business owner.
2. The death benefit is income tax free to the beneficiary (assuming compliance with Tax Code Section 101(j)).
3. At the death of an owner, the surviving owners have the option of using the death benefit to buy the ownership interest of the deceased owner or can contribute the death benefit to the company and have the company buy the ownership interest. In other words, they can treat the agreement as either a cross purchase or an entity buy-sell.
4. The purchase of the shares is generally not an income or capital gains taxable event to the heirs whether the agreement is treated as a cross purchase or an entity buy-sell. Also, the surviving owners will increase their cost basis in the business through the capital contribution if they choose an entity purchase or will receive a full step up in cost basis on the purchased interest if they choose the cross purchase option.

One Way Buy-Sell

A great way to protect the transition of a family business to the next generation.

How it works:

1. A business may have just one owner, but a family member or key employee is interested in succeeding the current owner. Business continuation for sole-owner businesses may provide challenges, since there isn't a clear line of succession and business interruption is very possible.
2. In addition to a written "one way" buy-sell agreement between the parties, the successor owns and is beneficiary of a life insurance policy covering the business owner.
3. If the business owner dies, the successor receives the death benefit income tax free.
4. The successor uses the death benefit to buy the business from the deceased owner's heirs.

The Living Benefit Buy-Sell

This form of buy-sell lets the owners prepare for the best while protecting against the worst.

How it works:

1. The business owners enter into a written buy-sell agreement committing to sell their interest and buy the interest of the other owner(s).
2. You and the other business owners own and are the insured on an individual life insurance policy. Each owner collaterally assigns some (or all) of the death benefit to the other owner(s) or names the other owner(s) as irrevocable beneficiary in a sufficient amount that allows the other owner to buy the business interest. The remaining death benefit can go to family or other beneficiaries.

   NOTE: If the buy-sell is designed to cover owners of a corporation, their assignment or irrevocable beneficiary will be to the corporation (as in the entity purchase above).
3. Doing so creates an economic benefit for each owner equal to the cost of basic coverage in the amount of the assigned portion of the death benefit (as defined in IRS Table 2001). Each owner recognizes that amount as taxable income.
4. As owner of their own policy, each business owner is free to fund the life insurance policy in whatever amount is desired to build a cash value that the owner can use, subject to any restrictions in the buy-sell agreement. The owner can use that cash to supplement his or her individual retirement, buy out retiring or departing co-owners, handle family expenses such as tuition, or any other purpose not limited by the buy-sell agreement.
5. Most business owners retire from their business, so it's good to be prepared for your co-owner's retirement as well as having financial protection against an owner's death. This form of buy-sell allows flexibility to provide for those possibilities.

It's important to work with your attorney to draft the buy-sell agreement that's best for your situation – and to work with your insurance and financial advisor to design the insurance coverage that best protects and benefits you and your family.

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