

Buy-sell agreements

Allianz Life Insurance Company of North America



Buy-sell agreements can help protect the continuity of your business after a potentially disruptive event, such as the death of a partner.

How does a buy-sell agreement work?

A buy-sell agreement is a legally binding contract that can help ensure the smooth continuation of a business when an owner leaves or dies.

When a buy-sell agreement is exercised, it allows a business entity, shareholder, or partner to purchase an interest in the business from the departed owner. Typically, buy-sell agreements specify when, to whom, and at what price an interest in the business will be sold.

Buy-sell agreements can be useful as part of an overall business-continuation strategy. But before you set up a buy-sell agreement, you should consult a tax advisor or attorney for guidance on your unique situation. To work as intended, buy-sell agreements must be drafted carefully.

Benefits of a buy-sell agreement

If they're properly structured, buy-sell agreements can help ensure a smooth transition for and continuation of your business. A buy-sell agreement may be a good fit if you have a specific business succession strategy in mind, or if you want to prevent outsiders from getting control of your business.

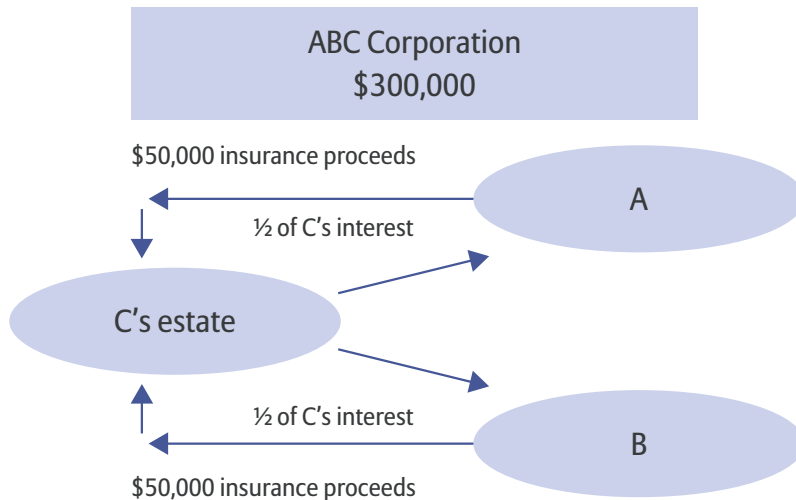
Having a buy-sell agreement may also be reassuring to your creditors, customers, and employees. Such an agreement could even help safeguard the value of your business and protect its entity status (if your company is an S corporation or a limited liability company, for example).

In some cases, buy-sell agreements may also help prevent unexpected estate-tax consequences upon the business owner's death. Buy-sell agreements allow you to fix the purchase price as the estate-tax value of a deceased owner's business interest, which may help you avoid future valuation problems with the IRS.

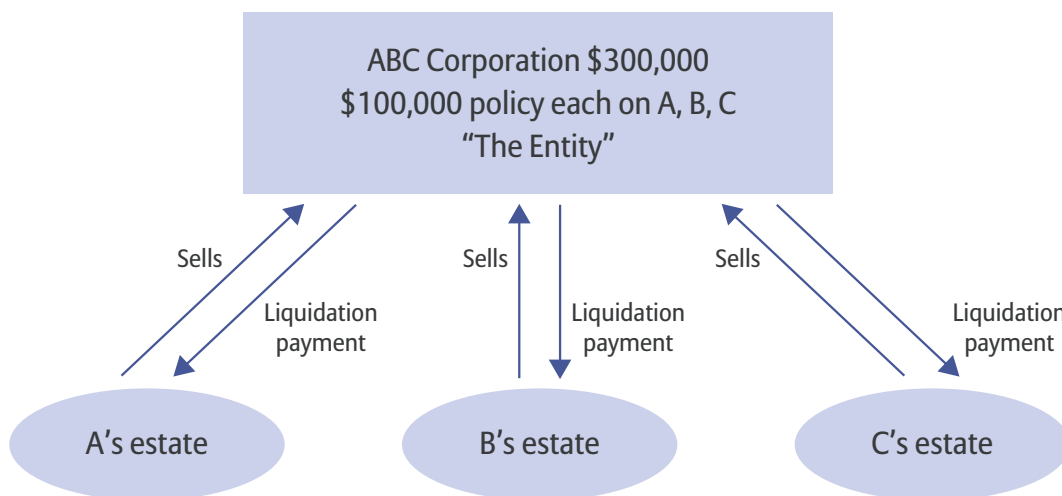
Types of buy-sell agreements

There are two main types of buy-sell agreements. In a **cross-purchase** agreement, each business owner buys a life insurance policy on the other shareholders. Upon the death of the first owner, the remaining shareholders receive the death benefit from the life insurance policy(ies).

Here's a hypothetical example:¹ Suppose shareholders A, B, and C each have a one-third ownership of \$100,000 in the business. Each shareholder buys a \$50,000 life insurance policy on the other two (so, in total, six policies are purchased). If shareholder C were to pass away, shareholders A and B would each use their \$50,000 policies on C's life to buy out C's interest in the corporation.



Entity purchase buy-sell agreements may be more appropriate for larger companies that have more shareholders. In an entity purchase agreement, the business purchases only one policy per owner. Upon death of the owner, the business collects the death benefit from the policy and uses it to "buy the owner out" by making a liquidation payment to his or her estate, as shown in this hypothetical example:¹



¹This hypothetical example is provided for illustrative purposes only. It does not depict an actual buy-sell agreement, nor is it intended to serve as a model for establishing such an agreement.

Setting up the agreement

To be valid, buy-sell agreements must clearly specify the conditions under which the interest in the business will be sold. This includes listing events that will trigger the buy-sell agreement, such as:

- Death of a business owner
- Retirement, resignation, or termination of a partner or shareholder
- Long-term disability
- Legal, personal, or financial problems

After you've determined the "trigger events," you'll need to establish a purchase price.

An independent business valuator can help you determine the fair market value of your business.

Although it may be tempting to guess at a figure or skip this step, it's critical in preventing potential disputes or unintended tax consequences down the road. Also, keep in mind that valuations may need to be updated periodically.

Implementing a buy-sell agreement

Although a buy-sell agreement is usually a contingency strategy, you may still want to give some thought to its implementation. Would you and your business partner(s) be able to execute the agreement, if needed?

To be successful, there must be funds available to carry out the terms of a buy-sell agreement. Without a funding strategy in place, the buyer(s) could be forced to take out a loan, sell assets, or perhaps even declare bankruptcy.

Fortunately, there are several ways to fund a buy-sell agreement: You can use cash, redeem some stock, draft a self-canceling installment note, and so forth. Depending on the size of your business – and your liquid assets – one of these options could be a good choice.

But if you don't have the necessary funds, another option may be to purchase life insurance to fund the buy-sell agreement (see the illustration at left).

Ask your financial professional whether funding a buy-sell agreement with life insurance may be a good option for your business.

This piece is designed to provide general information on the subjects covered. Pursuant to IRS Circular 230, it is not, however, intended to provide specific legal or tax advice and cannot be used to avoid tax penalties or to promote, market, or recommend any tax plan or arrangement. Please note that Allianz Life Insurance Company of North America, its affiliated companies, and their representatives do not give legal or tax advice. You are encouraged to consult your tax advisor or attorney.

Life insurance provides a death benefit – and so much more. Look beyond the death benefit and see how *your* insurance can be "bigger than life."

Call your financial professional today to learn more about how life insurance can be an important part of your business-planning strategy.

Allianz. Financial solutions from A – Z.®

Guarantees are backed by the financial strength and claims-paying ability of Allianz Life Insurance Company of North America.

www.allianzlife.com

Products are issued by:

Allianz Life Insurance Company
of North America
5701 Golden Hills Drive
Minneapolis, MN 55416-1297
800.950.1962

Product availability and features may vary by state.

(5/2009)