BUY-SELL AGREEMENTS:

WITH THE SRP

STRYDE

Buy-Sell Agreements with SRP

What is a Buy-Sell Agreement?

While business owners hope to be successful enough that they have cash on hand to buy a partner's interests out after an unexpected death, that's not always the case. Even if it is, a lack of pre-planning can create an unfavorable situation when valuing the business and determining the method of payment.

Buy-sell agreements create a two-pronged approach to ensure the continuation of the business after the death of one of the owners. First, these agreements spell out the means by which the business will be valued at the time of an owner's death. In addition to establishing an easy to define valuation method, they also (when properly structured) provide the funding with which the surviving owner(s) can purchase the deceased owner's shares, thus allowing business and personal capital to remain untouched.

One of the ways that a buy-sell agreement can fund the purchase of the interests is by establishing the purchase of a life insurance policy for each owner. All or a portion of the death benefit is then used to buy out the interest based on the valuation method chosen in the agreement.

Insurance isn't the only way to fund a buy-sell agreement. Businesses can also choose to fund them with annuities, which may be preferred if one or more of the business owners happen to be uninsurable.

Who Needs a Buy-Sell Agreement?

Businesses with one or more partners should consider implementing and funding a buy-sell agreement immediately at inception of the business. Doing so ensures not only that there is no question of how the business continuation and succession is to be handled upon the death of an owner, but also that the remaining owners will have the liquidity to fulfill the agreement and the business won't suffer adverse consequences due to funding delays.

Buy-sell agreements don't just lay out the terms of a purchase and sale under the death of an owner, however. They can also include other triggering events such as the disability, resignation or retirement of an owner. When funded with a permanent life insurance policy, the cash values accumulating in the policy or policies can even be used to fund the agreement in a non-death situation.

A buy-sell agreement isn't just a positive step for the owners; in the event of one owner's death, it also serves the best interests of the heirs. Without a funded buy-sell agreement, the heirs would likely inherit the business interests of the deceased owner and may not know what to do with them, or have to wait for a qualified buyer to buy them out and get the liquidity they need. Lastly, while a former partner may have been essential to the business, the heir may interfere and inhibit progress. Excess proceeds of the life insurance can help to secure a valuable replacement for the deceased partner.

How Buy-Sell Agreements Work

The first step in developing a buy-sell agreement is to determine which type of agreement the client wants: Cross Purchase or Stock Redemption.

CROSS PURCHASE AGREEMENTS

With a cross purchase agreement, each of the company owners agrees to purchase life insurance on the others. They personally pay the premiums on each of the policies and are the policy owners and beneficiaries of the coverage they secure.

When an insured owner passes away, the death benefit is immediately paid to the other shareholders who will use the funds to buy the deceased owner's shares based on the terms of the agreement. If the tax basis of the shares is the same as the valuation for the buy-sell, the heirs receiving the buyout may not have to pay taxes on the income. *

STOCK REDEMPTION AGREEMENTS

In this arrangement, the company buys insurance on each owner, rather than the owners buying the various policies on each other. The death benefit is then paid directly to the business upon death of the shareholder. The funds are used to purchase the deceased owner's shares.

Companies with multiple owners of varying ages and health conditions often favor this method for its fairness and ease of managing.

Company Valuation

Before funding the agreement, the owners need to know how much insurance coverage to purchase on each partner. After deciding which type of agreement structure they want, the owners must then agree on how to value the business. There are several ways to value the business:

Owners can decide on a fixed amount per share and, as the business grows, may annually or periodically reevaluate that and increase death benefits accordingly.

Owners may agree on a particular formula using a moving value such as book value or fair market value. This will allow for a value that grows, along with the business, over time. Again, death benefits should be periodically reevaluated so that proper buy-sell funding is ensured.

Funding the Agreement

A buy-sell agreement can be funded in many different ways. Some companies, when they have sufficient liquidity, may decide to self-fund the agreement. Most choose the easy, flexible, affordable structure of permanent life insurance policies to generate the cash that will be necessary for the execution of the agreement whether its due to death, disability or resignation.

ADDITIONAL NOTES REGARDING CROSS PURCHASE AND STOCK REDEMPTION

In a redemption, if the deceased owner had a controlling interest in the business, the corporation's ownership of the insurance policy could be construed as an instance of ownership. This means the death benefit would be considered part of the owner's estate and, thus, subject to estate taxes.

Cross purchase plans can be difficult to manage fairly when there are many owners with disparities in premiums brought on by health issues as well as varying ages and smoking classifications.

Policies owned by the business can be subject to claims of company creditors. However, the policies' cash values can be recorded as an asset on the company's balance sheet.

Life insurance policies purchased by individual owners could be subject to personal creditors and may be factored into applicable state taxes and alternative minimum taxes.

Using SRP to Fund Your Client's Buy-Sell Agreement

Insurance premiums for policies that are used to fund buy-sell agreements can be substantial, and can be difficult for many business owners to manage. For cross purchase agreements, the personal requirement to pay premiums can take a substantial amount out of each owner's income. With redemption agreements, the company must have enough cash on hand to pay for all of the policies—regardless of how expensive the premiums might be due to the health or age of some of the owners.

Stryde's SRP are life insurance and annuity funding strategies that create an alternative means to pay necessary premiums without tying up company cash or personal income.

By utilizing Stryde's SRP, individual owners and corporations can easily fund buy-sell agreements using life insurance policies with death benefits that will fulfill the obligations brought on by the valuation methods chosen.

How It Works

The premium financing loans available through STRYDE allow your clients to fund either a cross purchase or redemption buy-sell (as well as many other structures, such as split dollar) without any additional collateral outside of the policy used to fund the agreement.

When a business is first starting out, the decisions about what to do with cash can make or break the company's future. Later on, strategic investments can increase the company's growth and future prospects. This leaves little flexibility for business owners to pay for premiums that fund their buy-sell agreement. Even a cross purchase plan, with its heavy focus on individual policies purchased by each owner, the financial burden can be tremendous. SRP offer a great way for business owners to protect their business and personal capital while still fulfilling their most valued succession and legacy plans.

Loan Terms

Rates for the loans are either variable Libor-based rates or Prime–based, making them on par with the bank-to-bank overnight lending rates. If your client prefers a fixed loan, they can choose terms of 1, 5 or 10 years or they can select a Libor-based loan with added points. Loan origination fees can be financed or distributed over the premiums paid in the first year, which means no upfront funds are necessary.

*All clients must confer with their financial and tax advisors on deductibility or tax treatment matters. Stryde Solutions (STRYDE) does not provide tax advice.

that ensures your clients get a loan that works for them.

For example, some loans may be structured so that the cash values building up within the financed policy can be accessed by the owner to pay future premiums to keep the policy in force or to make interest and principal payments.

Owners can also choose to add additional benefits to the policies in order to cover other expenses that could occur upon the death of an owner.

These additions might be unaffordable when trying to self-fund the policy premiums, but through premium financing they can be within reach.

Stryde Solutions, LLC
StrydeSavings.com

1100 Torrey Rd. Suite 100, Fenton MI 48430
888.705.7662