

Buy-Sell Funding Toolkit



Concept Overview — Cross Purchase

CLIENT PROFILE: Business owners who wish to have the life insurance used for a Buy-Sell Agreement paid for and owned by the owners.

SETTING-UP AND FUNDING THE PLAN

Business establishes a cross purchase buy-sell agreement. Owners as a group agree to purchase the interest of any owner at a triggering event (death).

(1)

Each owner buys a life insurance policy on each other owner in an amount sufficient to fund a buy-out based on the value of the ownership position in the business. Each business owner is the owner, beneficiary and premium payer of the policy or policies.

(2)

AT DEATH

When an owner dies, the life insurance proceeds are paid directly to the surviving owner(s)/beneficiary(ies). Death benefits are received income tax-free. The money is then used to purchase the business interests from the deceased owner's estate.

(3)

The estate of the deceased owner will receive the proceeds of the sale largely income tax-free.

(4)

ADVANTAGES

- Cash value and policy generally not subject to the creditors of the business.
- Surviving owners receive full basis credit in stock purchased from estate.
- Minimal taxes due on sale of stock for heirs.

DISADVANTAGES

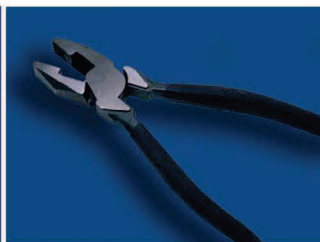
- Cash value and policy are not asset of corporation, therefore cannot be shown on books.
- Policies are subject to individual's creditors.
- Premiums are paid from personal funds and may be disproportionate since younger owners must buy and pay premiums for older owners.
- Very cumbersome to purchase and administer the policies.

- 1.) A cross purchase agreement is drawn up. The document spells out what would happen if a triggering event, such as death or disability of an owner, occurred. Other triggering events could include personal bankruptcy, retirement, or voluntary or involuntary termination of the owner. The surviving owners agree to purchase the business interests of the other owner in the event of a triggering event.
- 2.) Life insurance policies are purchased on each owner in an amount that is equal to the value of their interest in the business. Each owner must purchase a policy on each other owner, which is often a cumbersome process.
- 3.) Each business owner uses the income tax-free death proceeds to purchase a portion of the business from the estate of the deceased. The surviving owner will receive a full basis step up for that portion purchased from the deceased owner's estate.
- 4.) The stock value receives a step up in basis at the decedent's death. Provided the transaction takes place in a timely manner, the estate usually realizes no capital gain and no income tax is payable.

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Concept Overview — Entity Agreement

CLIENT PROFILE: Business owners who wish to have the life insurance used for a Buy-Sell Agreement paid for and owned by the business.

SETTING-UP AND FUNDING THE PLAN

Business establishes an entity purchase agreement (also called stock redemption for corporations). Owners agree to sell their ownership position in business to the business at a triggering event (death).

(1)

Life insurance is purchased on each owner in an amount equal to the value of his ownership position in the business. The business is the owner, beneficiary and premium payer of the policy.

(2)

AT DEATH

Life insurance proceeds are paid directly to business. Death benefit received income tax-free.

(3)

Business pays the estate of the owner who dies an amount equal to the value of the ownership position in the business.

(4)

With the use of a permanent life insurance policy, the cash value of the policy can be used to provide funds in case of disability, retirement, or voluntary or involuntary termination of the owner. Disability insurance policies can also be used to provide coverage.

(5)

ADVANTAGES

- Cash value of policy is asset of the business.
- Easy to administer.
- Premium paid for by business—equalizes the premium payments across owners.

DISADVANTAGES

- Policies and cash values subject to business creditors.
- Surviving owners receive no increase in cost basis of percentage of business redeemed.
- Business value may increase for estate tax purposes because death benefits flow to business.

- 1.) An entity purchase agreement is drawn up. The document spells out what would happen if a triggering event, such as death or disability, of an owner occurred. Other triggering events could include personal bankruptcy, retirement, or voluntary or involuntary termination of the owner. The owners agree to sell their business interests in the company back to the company at the triggering event.
- 2.) Life insurance policies are purchased on each owner in an amount that is equal to the value of their interest in the business. Some businesses will take into account the fact that the value may increase over time and purchase an amount greater than the actual value, with the balance being used as “key person” coverage. The business will be the owner and beneficiary of the policies. The business will also pay all premiums. This will be a non-deductible expense of the business.
- 3.) At death the insurance carrier pays the tax-free life insurance benefit directly to the business.
- 4.) The business uses the death benefits to pay the estate of the deceased an amount equal to the value of the business interest of the deceased owner. Additional coverage may have been purchased as “key person” coverage, which would provide the business with a cushion to offset the loss of the owner.
- 5.) While term insurance will provide a death benefit, the use of permanent life insurance can provide funds for other types of buy-outs when death does not occur prematurely. The cash value from the policy can be accessed in a tax efficient manner, providing more flexible plan funding.

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Buy-Sell Funding Fact Finder

This Fact Finder is designed to provide you with a method to gather the necessary information to develop an effective Buy-Sell Funding strategy. Please note that we have also included questions as part of this data collector that can be used to open up your prospects to further dialogue to uncover additional issues for which you can provide solutions.

General Information

Date	FactFinder taken by	
Company Name	Tax ID Number	
Address		
City	State	Zip Code
Contact Name	Title	
Office Phone	Mobile	Email
Description of Business		

Business Ownership

Name	Ownership Percentage	DOB	Sex	Smoker/ Non-Smoker	Family Member (Y/N)	Compensation	Health Issues, if any

Business Entity

Corporation

- ☐ C Corporation
- ☐ S Corporation
- ☐ Limited Liability Company (LLC)
- ☐ Partnership

General

- ☐ Limited
- ☐ Limited Liability Partnership (LLP)
- ☐ Limited Liability Limited Partnership (LLLP)

Other

- ☐ Professional Corporation
- ☐ Sole Proprietorship
- ☐ Other

Notes

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Reasons for Buy-Sell Agreement

- ☐ Provide liquidity at death
- ☐ Create a ready market for the business
- ☐ Provide for orderly transfer of business
- ☐ Set a fair price for the value of the business
- ☐ Estate planning purposes
- ☐ Prevent unwanted third parties from becoming owners
- ☐ Provide for owners in case of disability
- ☐ Preserve S Corp status
- ☐ Other _____

Events (to be) addressed in Buy-Sell Agreement

- ☐ Death of owner
- ☐ Disability of owner
- ☐ Normal retirement
- ☐ Termination of employment other than above reasons
- ☐ Divorce
- ☐ Bankruptcy or creditor claim against an officer
- ☐ Using business interests as collateral in an outside loan
- ☐ Other _____

Value of the Business

How much is the business worth? _____

How was the business value determined?

- ☐ Owner's estimate
- ☐ Appraisal
- ☐ Book value
- ☐ Goodwill
- ☐ Capitalization of earnings
- ☐ Other _____

Last three (3) years Revenue / Profits

200__	\$ _____	/ \$ _____
200__	\$ _____	/ \$ _____
200__	\$ _____	/ \$ _____

Will the business be sold or passed on at death?

- ☐ Have not yet decided

If passed on, to whom? _____

If sold, who would buy?

- ☐ Other owners
- ☐ The business itself
- ☐ To be determined at time of triggering event
- ☐ ESOP
- ☐ Control to business owners/interests to heirs
 - ☐ How structured/costs, etc.
- ☐ Third party
 - ☐ After being offered to other owners/entity first?
 - ☐ Yes
 - ☐ No
 - ☐ Who is third party? _____
- ☐ Other _____

If business to be sold, how should it be paid for?

- ☐ All cash
- ☐ Some cash, balance over time
 - ☐ Terms, Interest Rate _____

Notes

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Do you have funds set aside for?

☐ Death Y N How much? _____
☐ Disability Y N How much? _____
☐ Retirement Y N How much? _____

Do you have insurance for?

☐ Death Y N How much? _____
☐ Disability Y N How much? _____
May I have copies of your insurance policies to review? _____

If no insurance in place, why not? _____

Show insurance to fully/partially fund Buy-Sell Agreement for: Death / Disability / Retirement

What types of benefits do you have in place at this time? _____

Retirement Plan? Yes No Type _____

Health Insurance Group STD Group LTD Carve-out DI Section 162 Bonus Deferred Comp

Other _____

Advisors

Attorney

Name _____ Firm Name _____ Phone _____

CPA

Name _____ Firm Name _____ Phone _____

Other Advisor

Name _____ Firm Name _____ Phone _____

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Questions to accompany the Buy-Sell Funding FactFinder

(Wording of questions, etc. will be influenced by whether a Buy-Sell Agreement is in place or contemplated.)

Business Ownership

- ☐ Who started the company?
- ☐ What role do the owners play?
- ☐ Could you survive if one owner was no longer a part of business?
 - ☐ Which owner and why?
- ☐ What is ownership percentage based on?
 - ☐ Has it changed?
 - ☐ Will it change?
- ☐ How is compensation determined?
- ☐ Who are family members?
 - ☐ What is relationship?
- ☐ Are there any health issues with owners?
 - ☐ Is that a factor in business?

Business Entity

- ☐ How or why was business entity chosen?
- ☐ Has it changed and why?
- ☐ Do you foresee it changing in the future and why?

Reasons for Buy-Sell Agreement/Events

- ☐ Is there one most important reason?
- ☐ Have the owners talked about these reasons among themselves?
 - ☐ Among their families?
- ☐ Do you think that there might be estate tax issues?
 - ☐ Have you talked to anyone about this?
- ☐ Are there any estate planning issues that should be addressed in Buy-Sell Agreement?
 - ☐ Ability to gift, etc?

Events addressed by Buy-Sell Agreement?

- ☐ If one of these events was not addressed, why not?
- ☐ How would the business pay an owner who was disabled?
- ☐ At what age do you expect to retire?
- ☐ Have there been any divorces?
 - ☐ How did they affect the business?
- ☐ Have there been any bankruptcies or claims?
 - ☐ How did they affect the business?
 - ☐ Any owners with outside business interests?
- ☐ Any business owners who have used business interests to collateralize a loan?

Value of Business

- ☐ If I wrote a check today to sell the business to me, what would it have to be?
- ☐ How has the business value grown in the last 5 years?
 - ☐ What do you think it will be in 5 years, 10 years?
- ☐ Have you had a professional valuation?
 - ☐ How? What was value?
 - ☐ Who did it?
- ☐ What percentage of your net worth is tied up in the business?
- ☐ Do you have key employees?
 - ☐ What have you done to tie them to the business?
 - ☐ Would you like to tie them to the business/for how long?

Last three years revenues/profits

- ☐ Why have the business profits gone up/down?
 - ☐ What do you expect will happen over the next 5 to 10 years?
- ☐ Is there one thing that will affect your business revenue and profits?
 - ☐ Can you control it?
- ☐ Is there one person who is most responsible for the revenue and profits?

Will the business be sold or passed on at death?

- ☐ If you have not decided, why not and when will you?
- ☐ If passed on, to whom?
 - ☐ Are they part of the business now?
 - ☐ What is their job? How are they doing?
 - ☐ What is their relationship with other owners?
 - ☐ Are there family owners who are not in the business whom you would want to benefit from value of business?
- ☐ If sold to owners/business:
 - ☐ Is final percentage of ownership worked out now?
 - ☐ Are there skills that other owners lack?
 - ☐ Will others have to be hired to fill that skill-set?
- ☐ If sold to third party:
 - ☐ Why? What does third party bring to company?
 - ☐ Is third party part of company now?
 - ☐ What is being done to keep third party?
- ☐ If no funds set aside:
 - ☐ How will you pay?
 - ☐ Is there a plan set up?
 - ☐ If I can show you an efficient way to fund, would you be interested?
- ☐ If insurance is not in place:
 - ☐ Have you ever looked at purchasing insurance coverage? If you have, why didn't you buy?
 - ☐ If I can show you an efficient way to fund, would you be interested?
- ☐ If insurance is in place:
 - ☐ Who did you buy from?
 - ☐ What is relationship today with agent?
 - ☐ Do you know life insurance costs have come down dramatically in the last 10 years? Have you reviewed your policies lately?
 - ☐ The disability insurance marketplace has changed lately. Have you reviewed that coverage?

Advisors

- ☐ How did you pick your Advisors?
 - ☐ Are they friends of any of the owners?
- ☐ Have they worked with you on your Buy-Sell Agreement?
- ☐ Can I contact your Attorney and CPA directly to discuss the Buy-Sell Agreement and funding?

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Getting Started

Identifying Potential Candidates / Buy-Sell Funding Prospects

PART I — YOUR CLIENTS

Check your client list to make sure that you have spoken with all of your clients who are business owners. And if you have spoken to business owners in the past who have not followed your advice and prepared and/or funded a Buy-Sell, go back again with the questions and materials in this Toolkit.

Ask yourself:

- ☐ Do you have clients who have a business but no Buy-Sell Agreement?
- ☐ Do you have clients who have a Buy-Sell Agreement, but have not funded it?
- ☐ Do you have clients who have a Buy-Sell Agreement, funded it, but have not reviewed it lately?
- ☐ Are there clients who have started a business since you last spoke to them?
- ☐ Are there clients with family members who have a business – can you get a referral to speak to them?
- ☐ Do you have clients who are sole proprietors? Even if they do not have a partner, they still should deal with the issue of disability and death. They still have people who depend on them.
- ☐ Do you have clients who you have worked with in the past who can refer you to other business owners?

List clients below:

Once you have identified the clients you can contact them and schedule a meeting. Use the Q&A and the Implementation Steps, if needed, for a pre-meeting approach, depending on the level of understanding of the client. Use the Consumer Toolkit pieces to educate them about Buy-Sell Funding. Use the Fact Finder to gather information. Contact your Sales Manager to obtain more information and illustrations.

PART II — PROSPECTS

Buy-sell funding prospects are easier to find than other prospects, simply because it is easier to identify business owners than other types of prospects. However, since they are often approached by many financial service professionals, you need to set yourself apart. A technique to help you do this is by truly listening to your prospects. There is a tendency for us to try to make a good impression by taking too much time telling the business owner about our services and us. Briefly explain yourself in a way that sets you apart from your competition, and then let the business owner talk. In order to cultivate prospects, try some of the following:

- ☐ Develop relationships with the people you do business with on a daily business – the dry cleaner who cleans your business suits, the car dealer who sold you your car, the real estate agent who sold you your house. Everyone you do business with is a prospect. The best way to get a meeting on a favorable basis is to develop a relationship with them and get them to talk about their business. Take the time to develop a favorable relationship. Once they are comfortable and you are viewed as non-threatening, ask them questions and let them talk.

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- Keep an eye out for new businesses and businesses in transition, for example, showing rapid growth, opening new offices, etc. Positive changes in the business world often signal opportunities for you.
- Purchase or develop lists of business owners in your area and target mail with a follow up phone call. Use the Prospecting Letters as a template.
- Develop a simple brochure to outline all of the services you provide. Oftentimes business owners are not aware of all of the services that you can provide – make them aware.
- Use the Prospecting Flyer, a mailer that can be personalized, to introduce your services and the Buy-Sell concept.
- Develop a good “elevator speech,” a one minute blurb that makes you different from others. You don’t sell insurance; you “help business owners pass on the fruits of their labor to the next generation, something that many business owners are finding harder to do.” And tailor your “speech” to the situation – to the particular concerns that the business owner might have.
- Join local business organizations – Rotary, Lions, etc. Use your time there to gain an understanding about the other business owners in the area. Find out who their advisors (CPAs, Attorneys) are, so that you might “surround” them. In most situations, the advisors are an important part of the process, find out who they use for legal and accounting work – maybe you already know them, if not, you need to get to know them.

Once you are sitting in front of a Buy-Sell Prospect and you have explained your practice to them, what do you say? Below is a list of questions you can ask that can lead to traditional Buy-Sell life insurance sales, as well as other sales (key-man coverage, disability insurance, retirement planning, etc.). Listen well and pick out the issues and concerns of the business owner – then provide solutions as only you can.

If they have no Buy-Sell Agreement in place:

- What would you sell your business for today? How much of that value is because of your efforts? If you were not here, what would your business be worth? How can you be sure your heirs will receive that amount?
- Should your heirs liquidate your business at your death? If so, how much would they get? Would the fact you are no longer a part of the company affect the sale or the price received? If you do not know yourself now what they should do, how would they know what to do if you are no longer there to advise them?
- Do you have a family member that wants to take over the business one day? If so, are there other family members that you would like to see benefit from the efforts of your work even though they are not in the business?
- Do you have any idea if you will owe estate taxes on the value of your business? If so, have you planned for that payment? If not, would your heirs have to liquidate the business, part of the business to pay the taxes due? Are you sure that the IRS will not place a higher value on the business than you think it is worth?
- If you should die prematurely, would your spouse be able to run the business? Would your spouse get along with your partner(s) even if capable of running the business? If not, what steps have you taken so far to deal with that?
- Do you or your partners have any debts that would have to be repaid at death? Are you a guarantor of any debts for others?
- What is your strategy for retiring and selling the business? Have you thought about the fact that something might happen before that time comes? Have you planned for that? Is there a source of income that your family could draw upon if you could not work or died?
- What would happen to your share of the stock in the company should you die? Would your family receive dividends from the business for income? For how long? Is there another source of income from the business? Could the business or your partners afford to pay it?
- If one of your partners dies, retires or is disabled, how would you deal with it? Could the business afford to continue to pay a salary even if the partner no longer contributes to the business? Is there money for a buy-out in case of retirement or death?
- If you are speaking to a sole proprietor:
 - Is there an employee who could step in if you died or were disabled? What are you doing to keep that employee in the company? Is that employee interested in buying your business some day? Does that employee get along with your spouse/your family?

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If they have a Buy-Sell Agreement in place, but do not have it funded with life or disability insurance:

- ☐ How would you fund the Buy-Sell Agreement if there were a triggering event? Is there a sinking fund or some other funding mechanism?
- ☐ Do you have an insurance agent that you work with? Why didn't you purchase insurance to fund the agreement from him/her?
- ☐ Have you ever looked into the cost of insurance? If I could show you how to fund the agreement efficiently with insurance, would you be interested in working with me?
- ☐ Are there any health issues keeping you from purchasing insurance?

If they have a Buy-Sell Agreement in place, funded with life insurance, but not disability insurance:

- ☐ Do you know that you are much more likely to be disabled than to die before you reach retirement?
- ☐ If your partner were disabled and unable to work, would you pay him anyway? How would you pay him?
- ☐ You have insured your building, your vehicles, your inventory, etc., but you have not insured your most important asset – your ability to get up and go to work each day – why not?

PART III — ADVISORS — CPAs/ATTORNEYS

Advisors such as CPAs and Attorneys are great referral sources. Work to educate them about the services you can provide. They are often a part of the business planning that occurs and they can be advocates for the work that you do.

List those Advisors that you have a relationship with that you can go see now.

Use the Q&A and the Implementation Steps as pre-approach materials before the meeting. Or simply use those items during a face-to-face meeting. Take a Fact Finder and ask to do a proposal for a client just to show the advisor the work that you do.

Other Ideas:

- ☐ Use the Prospecting Letter template to create an inexpensive direct mail campaign to CPAs and Advisors in your area. Send the materials and then follow up 3-4 days later. Do not wait too long.
- ☐ Personalize the Prospecting Flyer and send with a handwritten note inviting the advisor to meet with you to discuss Buy-Sell Funding. Again, follow up by phone quickly.
- ☐ Contact local CPA and Advisor associations. Often they are looking for a speaker or they may have study groups that you can speak to.

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Implementation Steps

Steps to Set up and Fund A Buy-Sell Agreement

Owners discuss the need for a Buy-Sell Agreement and the reasons that a Buy-Sell Agreement is needed for their particular situation.

(1)

The value of the business is determined to the satisfaction of all involved.

(2)

An Attorney is hired to help determine the form of the Agreement and to prepare legal documentation for the Agreement.

(3)

The Buy-Sell Agreement is funded utilizing life and disability insurance and other funding vehicles.

(4)

The Buy-Sell Agreement and funding mechanisms are reviewed frequently.

(5)

1.) Discuss the Need

The first step in setting up and funding a Buy-Sell Agreement is the recognition by the business owners that a Buy-Sell Agreement is needed. Reasons for a Buy-Sell Agreement include: creating liquidity, fixing the value of the business for estate planning purposes, setting a fair price for both buyer and seller and maintaining harmony among all owners and heirs.

2.) Value the Business

One of the most important benefits of a Buy-Sell Agreement is to fix a value of the business. It is advisable to work with a professional to place a value on the business. It is at this point that an accountant familiar with the business can be an important asset helping to coordinate the valuation of the business. The most common methods of valuing a business are:

Market Approach – The business is compared to a publicly traded business and then the value is adjusted accordingly.

Income Approach – The valuation is determined either by looking at the history of earnings or cash flow for the company and dividing by a capitalization rate for that industry (Capitalized Returns), or projecting future earnings for the company and applying a discount to determine the present value of that income stream (Discounted Future Returns Method).

Asset Approach – The valuation is based on the underlying assets of the company and their value.

Owner's Estimate – The simplest method, this is the price that the owner agrees is a fair price for the business.

3.) Attorney Is Hired to Draft a Buy-Sell Agreement

There must be a written document. A well-drafted and properly funded arrangement can protect the interests of the business owners and help facilitate the continuation of the business. Buy-Sell Agreements can take different forms, including: (1) Entity Purchase or Stock Redemption, (2) Cross Purchase, (3) Trusteed Cross Purchase and (4) Wait and See. It is important to understand which method the Attorney would like to use so that there are no complications in the future. When insurance is used to fund the plan, the form the arrangement takes will affect the ownership and beneficiary designation of the policies.

4.) Buy-Sell Agreement Is Funded

Life insurance is one of the most common vehicles for funding the Agreement in case of death. Life insurance has income tax advantages (tax-free cash build-up, income tax-free death benefit.) The cash value can also be used to fund the retirement of an owner. Other methods of funding include: borrowing funds, sinking fund, or installment purchase plan. Disability insurance policies can also be purchased to provide a lump sum and/or periodic payments to fund a buy-out. Insurance is the only vehicle that provides funds at the precise time they are needed. It also allows for the funding to be spread out over time creating fewer burdens on company cash flow.

5.) Plan and Funding Reviewed Periodically

As the business grows and events change, the Agreement should be reviewed periodically. Reviews should include structure of Agreement, value of business, funding options and amounts, etc. The insurance funding the Agreement should also be reviewed to make sure that it is as efficient as possible and provides the best value available in the marketplace at that time.

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Life Insurance Proposal Request

Fax the completed form to your Sales Manager to receive your illustrations.

Producer Information

Name _____
Company _____
Contact _____
Email _____

Today's Date _____
Phone _____
Fax _____

Business Information

Name of Business _____
Type of Business ☐ C Corp ☐ S Corp ☐ LLC ☐ Partnership
☐ Limited Partnership ☐ Sole Proprietorship

Tax Bracket _____
Type of Buy-Sell Arrangement ☐ Cross Purchase ☐ Entity
☐ Trusteed Cross Purchase ☐ Wait and See

Client

Name _____
Age _____ DOB _____ / _____ / _____ Save Age ☐
Sex ☐ Male ☐ Female
Class ☐ Smoker ☐ Nonsmoker ☐ Preferred ☐ Other
Table _____ Flat X \$ _____ / _____ yrs.

Face Amount _____
Company(ies) _____
Plan Name _____
State of Sale _____ Riders ☐ WP ☐ Other _____

Product Information

UL/VUL

Death Benefit

☐ Level
☐ Increasing by Cash Value
☐ Increasing – Return of Premium

Premium Solve

☐ Premium to Guaranteed – Pay _____ yrs.
☐ Premium to Endow – Pay _____ yrs.
☐ Achieve CV\$ _____ @age _____
pay premium _____ yrs.

Rate of Return for VUL (gross return) _____

WL

☐ Continuous ☐ Premium suspension

Modes _____

Pour in _____ 1035 ☐

Request # _____ of _____ for _____ (company name)

Comments:

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Buy-Sell Funding Toolkit



Disability Proposal Request

Fax the completed form to your Sales Manager to receive your illustrations.

Producer Information

Name _____

Today's Date _____

Company _____

Contact _____

Phone _____

Email _____

Fax _____

Client Information

Prospect Name _____

State of Residence _____

Age or DOB _____

Male ☐ Female ☐

Occupation _____

Tobacco Use? Yes ☐ No ☐

Specific Duties _____

Who is paying the premium?

Income _____

Employee ☐ Employer ☐

Is there other coverage in force? Yes ☐ No ☐

Group LTD \$ _____ Individual DI \$ _____

Medical Conditions _____

Benefits to Quote

DISABILITY INSURANCE

Monthly Benefit: \$ _____ or ☐ Maximum Available

Elimination Period: ☐ 30 days ☐ 60 days ☐ 90 days ☐ 180 days ☐ 365 days ☐ 730 days

Benefit Period: ☐ 2 years ☐ 5 years ☐ Age 65 ☐ Age 67 ☐ Lifetime

Optional Benefits: ☐ Own Occ ☐ Residual ☐ COLA ☐ Future Purchase Options ☐ Social Security Offset

BUSINESS OVERHEAD EXPENSE

Monthly Benefit: \$ _____

Elimination Period: ☐ 30 days ☐ 60 days ☐ 90 days

Benefit Period: ☐ 12 months ☐ 18 months ☐ 24 months

Optional Benefits: ☐ Residual ☐ Future Purchase Option ☐ Salary of Replacement

DISABILITY BUY-OUT

Monthly Benefit: \$ _____ or Lump Sum Benefit: \$ _____

Elimination Period: ☐ 12 months ☐ 18 months ☐ 24 months

Benefit Period: ☐ Lump Sum ☐ 18 months ☐ 24 months ☐ 36 months ☐ 60 months

Total Coverage Desired: \$ _____

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Buy-Sell Funding

What Is It?

A Buy-Sell Agreement can be one of the most important steps that your clients take to control the future destiny of their business. You have probably drafted documents that spell out exactly what will happen if an owner retires, suffers from a disability, or dies prematurely.

But creating the Buy-Sell document is just the first step. Unless the funds to implement the Buy-Sell Agreement are available at the precise time they are needed, the Agreement may not be able to be carried out.

Buy-Sell Agreement Funding is a two-step process. First, an Agreement is designed that is thoughtful and fair and covers every contingency. Second, steps are taken to make sure that the funds necessary will be there when needed to carry out the Agreement.

I can help with that second step.

Unless the funds to implement the Buy-Sell Agreement are available at the precise time they are needed, the Agreement may not be able to be carried out.

Plan Highlights

With proper Buy-Sell Funding Planning you can:

- Create the resources to purchase the business.
- Create liquidity for the estate of a deceased owner.
- Minimize the disruption to the business in times of crisis and aid in a smooth continuation of the business.
- Help to provide for the financial stability of an owner who is disabled and is unable to work.
- Aid in a smooth transition of owner(s) as they enter their retirement years.
- Fund the Agreement in an efficient manner.

For further information about how I can work with your clients to assist with the proper implementation of a Funded Buy-Sell Agreement, please call me:

FOR USE WITH ATTORNEYS

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Buy-Sell Funding

What Is It?

A Buy-Sell Agreement can be one of the most important steps you take to control the future destiny of your business. It is an agreement that spells out exactly what will happen when a specified triggering event occurs. Triggering events such as a business owner's death or disability often come suddenly and create a crisis that in some instances cannot be overcome. Proper planning beforehand minimizes the mistakes that may be made and maps out a strategy and a process that maximizes the benefits of your years of hard work. A financially secure retirement and the orderly passage of the business can be planned well in advance and use the value of time to great advantage.

Unless the funds to implement the Buy-Sell Agreement are available at the precise time they are needed, the Agreement may not be able to be carried out.

But creating the Buy-Sell document is just the first step. Unless the funds to implement the Buy-Sell Agreement are available at the precise time they are needed, the Agreement may not be able to be carried out.

Buy-Sell Agreement Funding is a two-step process. First, an Agreement is designed that is thoughtful and fair and covers every contingency. Second, steps are taken to make sure that the funds necessary will be there when needed to carry out the Agreement. I can help with that second step.

Plan Highlights

With proper Buy-Sell Funding Planning you can:

- Create the resources to purchase the business.
- Set a fair price for the heirs for the value of a business. In some instances, you can set the value of the business for estate tax purposes.
- Create liquidity for the estate of a deceased owner.
- Minimize the disruption to the business in times of crisis and aid in a smooth continuation of the business.
- Help to provide for the financial stability of an owner who is disabled and is unable to work.
- Aid in a smooth transition of owner(s) as they enter their retirement years.
- Fund the Agreement in an efficient manner.

For further information about how I can help you work with your clients to assist with the proper implementation of a Funded Buy-Sell Agreement, please call me:

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Buy-Sell Funding

What Is It?

You know that a Buy-Sell Agreement can be one of the most important steps that your clients take to control the future destiny of their business. You have probably worked with your clients and their Attorneys to craft documents that spell out exactly what will happen if an owner retires, suffers from a disability, or dies prematurely.

But creating the Buy-Sell document is just the first step. Unless the funds to implement the Buy-Sell Agreement are available at the precise time they are needed, the Agreement may not be able to be carried out.

Buy-Sell Agreement Funding is a two-step process. First, an Agreement is designed that is thoughtful and fair and covers every contingency. Second, steps are taken to make sure that the funds necessary will be there when needed to carry out the Agreement.

I can help with that second step.

Unless the funds to implement the Buy-Sell Agreement are available at the precise time they are needed, the Agreement may not be able to be carried out.

Plan Highlights

With proper Buy-Sell Funding Planning you can:

- Fund the sale of the business.
- Create liquidity for the estate of a deceased owner.
- Minimize the disruption to the business in times of crisis and aid in a smooth continuation of the business.
- Help to provide for the financial stability of an owner who is disabled and is unable to work.
- Aid in a smooth transition of owner(s) as they enter their retirement years.
- Fund the Agreement in an efficient manner.

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EVERYDAY SALES TOOLBOX — BUY-SELL FUNDING TOOLKIT

SAMPLE PROSPECTING LETTER ADVISORS (CPAs AND ATTORNEYS)

Once you've identified your current clients who fit the Buy-Sell profile, use this letter to introduce them to the concept. This letter can be used with the Prospecting Flyer for Attorneys or CPAs.

(Date)

(Client Name)

(Address 1)

(Address 2)

(City, State, Zip)

Dear (Client Name),

Do you have Business Owner clients? If yes, then one of the most important services you can provide to them is helping to design and document a Buy-Sell Agreement. With advance planning, the severity of a crisis impacting the business – such as disability, death, personal bankruptcy or retirement – can be minimized.

However, in the case of a Buy-Sell Agreement, the document, while providing a framework, cannot be implemented without a funding mechanism. I help Business Owners design a plan to fund a Buy-Sell Agreement so that the funds are available at precisely the moment they are needed.

I will contact you shortly to set up a brief meeting to discuss the work that I do and how we might be able to work together.

Sincerely,

(Agent Name)

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EVERYDAY SALES TOOLBOX — BUY-SELL FUNDING TOOLKIT

SAMPLE PROSPECTING LETTER BUSINESS OWNERS WITH PARTNERS

Once you've identified your current clients who fit the Buy-Sell profile, use this letter to introduce them to the concept. This letter can be used with the Client Prospecting Flyer.

(Date)

(Client Name)

(Address 1)

(Address 2)

(City, State, Zip)

Dear (Client Name),

Every day we hear about accidents or tragedies that take a life or disable people so that they are unable to continue working. And when we do, it always seems to happen to the "other person." How would you handle it if it happened to you? What would you do if it happened to your partner?

- Are you prepared if you cannot work for the next 6 months or the next two years, or ever again?
- Would your heirs receive the true value of your business if you die prematurely?
- What would you do if your partner were not here to help you? Would you be able to pay his salary if he were disabled? Would you be able to "buy-out" his spouse if he died, or would the spouse be your new partner?

I understand that these are not easy questions – they are troubling. They are questions we would rather avoid.

I work with Business Owners who are interested in insuring their future and, more importantly, their families' future.

I will contact you shortly to schedule a time to visit with you to start the discussion. I hope you will allow me to help you in this very important matter.

Sincerely,

(Agent Name)

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EVERYDAY SALES TOOLBOX — BUY-SELL FUNDING TOOLKIT

SAMPLE PROSPECTING LETTER

SOLE PROPRIETORS, SINGLE OWNERS

Once you've identified your current clients who fit the Buy-Sell profile, use this letter to introduce them to the concept. This letter can be used with the Client Prospecting Flyer.

(Date)

(Client Name)

(Address 1)

(Address 2)

(City, State, Zip)

Dear (Client Name),

Every day we hear about accidents or tragedies that take a life or disable people so that they are unable to continue working. And when we do, it always seems to happen to the "other person." How would you handle it if it happened to you? You built your business yourself; now what?

- Would you be able to support your family if you were unable to work?
- How would you pay your overhead if you had to close your business for a month or six months?
- What would your family receive for your business if you died today? Is it what you think it is worth?

I know that these are uncomfortable questions. But they are questions that warrant answers — for you, for your family, for your business.

I work with clients just like you to help answer these questions before a crisis happens.

I will contact you shortly to schedule a time to visit with you to start the discussion. I hope you will allow me to help you in this very important matter.

Sincerely,

(Agent Name)

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Buy-Sell Funding Toolkit



Questions and Answers

WHAT IS BUY-SELL PLANNING?

At the heart of a good business succession strategy is the planning that provides for the efficient passing of the business should the owner or one of the owners, die, become disabled, or wish to, or have to, leave the business for another reason. Buy-Sell Planning is one component of business planning and should be viewed within the context of long term business and succession planning. A Buy-Sell Agreement is the centerpiece of any Buy-Sell Planning.

A Buy-Sell Agreement is a legally binding document that spells out what will happen to a business when a specific event occurs.

WHAT IS A BUY-SELL AGREEMENT?

A Buy-Sell Agreement is a legally binding document that spells out what will happen to a business when a specific triggering event occurs, such as the death or disability of a business owner or shareholder. Other events typically covered include the resignation, retirement or termination of a shareholder or owner.

WHAT ARE THE BENEFITS OF A BUY-SELL AGREEMENT?

The major benefit of a Buy-Sell Agreement is that it allows for the continuation of the business by providing for an agreed upon transition of the business. In addition to providing a ready market for the business, it can ensure that the price for both buyer and seller is a fair one. The agreed upon price can, in many instances, set the value of the business for estate planning purposes.

WHAT IS MEANT BY A "FUNDED" BUY-SELL AGREEMENT?

While the Buy-Sell Agreement can provide the legal framework for the sale and transition of a business, it does not provide the cash needed to fund it. One of the most popular methods of funding a Buy-Sell Agreement is permanent life insurance. Based on current federal tax law, permanent life insurance has several tax advantages. The death benefit will be received tax-free, in most instances, and the cash value in the policy grows tax-deferred. The cash value provides a pool of money that can be accessed with tax efficiency to fund a buy-out. Other methods of funding a Buy-Sell include: term insurance, borrowed funds, a sinking fund, or an installment purchase.

HOW ARE BUY-SELL AGREEMENTS FUNDED WITH LIFE INSURANCE STRUCTURED?

The majority of Buy-Sell Agreements funded with life insurance are either Entity or Cross Purchase Agreements. Other methods include Trusteed Cross Purchase and Wait and See Agreements.

Entity Agreement (Stock Redemption Plan in a corporate setting) – In this arrangement the business enters into an agreement with the owners to purchase the business interests of the owner at a triggering event. To provide the cash to purchase those interests at death, the business buys life insurance on each owner in an amount equal to the value of their business interest. The business is the applicant, owner, and beneficiary of the policy. The business pays all premiums on the policy and the policy becomes a business asset. Any cash value in the policy is shown on the balance sheet and is subject to business creditors. An Entity Agreement is relatively easy to administer since the premium payments come from one source and the number of policies needed is minimized. At death the life insurance proceeds are paid to the business. The business uses those funds to purchase the deceased owner's business interests from the estate of the deceased. A major disadvantage of this type of agreement is that the remaining owners may receive no step up in basis or only a partial step up in basis on the shares purchased from the deceased owner's estate.

Buy-Sell Funding *Toolkit*



Cross Purchase Agreement – In this type of agreement the business owners each agree to purchase the business interests of any owner at a triggering event. In order to fund the agreement in case of death, each business owner buys a life insurance policy on each other owner for the amount needed to fund his or her obligation. The business owner is the applicant, owner, beneficiary and premium payor on policies for all of the other owners. At death, each surviving owner receives the death benefit proceeds directly from the insurance carrier and uses those funds to purchase from the estate of the deceased a pro-rata share of the business. A major disadvantage of this method is the number of policies needed to fund the agreement when there are more than two owners. If there are two owners, only two policies are needed. However, for more than two owners the number of policies needed is equal to the equation " $Y \times (Y \text{ minus } 1)$," where Y is equal to the number of owners. For example, if there were four owners, there would have to be 12 policies ($4 \times (4 \text{ minus } 1) = 12$).

Trusteed Cross Purchase Agreement – This type of agreement minimizes the number of policies needed to fund the agreement in case of death. First, a trust is established with an independent trustee. Thereafter, the business interests of all owners are placed in the trust and life insurance is applied for, owned and paid for by the trust. Under this approach, only one policy is needed per owner. Since the independent trustee is named as beneficiary, the trustee will collect the death benefit and pay the deceased owner's estate for the deceased owner's portion of the business. The trustee then apportions the business interests into each owners account within the trust on a pro rata basis. Although this seems like a very attractive method for handling a buy-sell, it is not without its drawbacks. The primary issue that must be addressed is for entities that have more than two owners and are not taxed as a partnership. Under this entity structure, "transfer for value" rules under IRC Sec. 101(a)(2) must be reviewed. Specifically, when an owner sells his business interests to the trust, either at death or retirement, he is also selling his indirect interest in the policies on the other owners. This could be deemed a "transfer for value" and could cause the death benefit to be taxable as ordinary income. If this is a concern, one solution might be the use of a partnership to hold the life insurance policies. Whatever the approach, the client's Attorney will have to determine the best approach based upon all facts and circumstances. An additional concern is the inclusion of life insurance in the estate of the deceased owner. As the trust is revocable, this is a real concern. Careful drafting of the trust document and the Buy-Sell Agreement may eliminate these risks.

Wait and See Agreement – If a decision cannot be made as to whether an Entity or Cross Purchase Agreement is more advantageous, a Wait and See Agreement can be drawn up. This allows the business owners to wait until a triggering event to decide on the course of action. In most situations an agreement is drawn up that gives the business the first option to purchase the stock at a triggering event. If the business does not purchase the stock, the business owners then have the option to purchase. If they do not exercise that option, the business would be required to purchase the stock. The Wait and See Agreement provides greater flexibility since the method of purchase is left to be decided until the time of the triggering event.

Buy-Sell Funding Toolkit



	Entity Purchase	Cross Purchase	Trusteed Cross Purchase	Wait and See	Insurance LLC
Owner	Business	Business owners own policies on each other	Trust	Depends on design, usually business owners	Insurance LLC
Beneficiary	Business	Business owners	Trust	Depends on design, usually business owners	Insurance LLC
Number of policies needed	One policy per owner	If 2 owners, then 2 policies. However if more than 2 owners, formula is $Y \times (Y-1)$ where Y = number of owners	One policy per owner held by a Trustee	Depends on design	One policy per owner held by the Insurance LLC.
Who pays life insurance costs?	Life insurance premium paid by all owners, based on their proportion of ownership.	Policy owners pay premiums. Costs are higher for policies on older owners.	Policy owners pay premiums through Trustee. Costs are higher for policies on older owners.	Policy owners pay premiums. Costs are higher for policies on older owners.	Life insurance premiums are contributed by the owners to the Insurance LLC as tax-free capital contributions based on their proportion of ownership. Premiums are made by the Insurance LLC. Costs are higher for policies on older owners.
Is death benefit subject to Alternative Minimum Tax?	Possibly	No	No	No	No
Advantages	Cash value of policy is asset of the business, relatively easy to administer, premium paid for by business – equalizes the premium payments across owners.	Policies not subject to business creditors, no AMT, sale by owners' estate will receive capital gains tax treatment and because of step-up of basis at death of owner there will be very little or no recognition of taxes.	Limited number of policies needed, policies not subject to business creditors, no AMT, sale by owners' estate will receive capital gains tax treatment and because of step-up of basis at death of owner there will be very little or no recognition of taxes.	The major advantage is flexibility. The ability to decide on exact course of action at the triggering event, not before.	One life insurance policy per owner. Full cost basis increase to the surviving owners. Provides an additional layer of creditor protection. Can integrate with owners' retirement and estate plans. No "transfer for value" concerns at dissolution.
Disadvantages	Policies and cash value subject to business creditors, surviving owners receive no increase in cost basis of percentage of business redeemed, business value may increase for estate tax purposes because death benefits flow to business.	Complex to administer because of number of policies, use of personal after tax dollars to fund premium, younger owners pay disproportionate premiums on older owners.	Possible transfer for value issue, use of personal after-tax dollars to fund premium, younger owners pay disproportionate premiums on older owners. Also, possible inclusion of life insurance proceeds in owner's estate.	Depending on actual design there could be multiple owners and administrative complexity, and inequality of total benefits received, or possibly no increase in cost basis of percentage of business redeemed.	Complex to administer because the business owners must keep accurate LLC capital accounts and the CPA/tax-preparer must understand how partnership taxation operates.

Buy-Sell Funding *Toolkit*



IF THE LIFE INSURANCE FUNDING THE BUY-SELL AGREEMENT IS OWNED BY THE BUSINESS, CAN THERE BE AN ISSUE WITH THE ALTERNATIVE MINIMUM TAX (AMT)?

Yes, there can be an issue with AMT if the business is a C Corporation, though according to current tax law, this would only apply to those C Corporations with annual gross receipts of over \$5 million. In those instances, both the cash buildup and death benefit greater than cost basis could be subject to the corporate alternative minimum tax of up to 15%. You should consult with your tax advisor if this could affect you.

ARE THERE ANY OTHER INSURANCE PRODUCTS BESIDES LIFE INSURANCE THAT ARE USED TO FUND A BUY-SELL AGREEMENT?

Yes, disability insurance is used to fund a buy-out should an owner not be able to work because of an injury or medical condition. The need for this type of coverage is vital as the chances for disability are much greater than death prior to retirement.

IS THE VALUATION OF THE COMPANY AN IMPORTANT COMPONENT OF BUY-SELL PLANNING?

Absolutely. One of the most important aspects of Buy-Sell Planning is determining a fair price for the business. Everyone should agree with that purchase price and the agreement should come before the triggering event. It allows the sales process to occur during a crisis without a conflict and also allows all parties to plan ahead with confidence.

CAN I SET THE PRICE OF THE BUSINESS FOR ESTATE TAX PURPOSES WITH A VALUATION?

The IRS will value the business interest at the "fair market value." According to Treasury Reg. Sec. 20.2031-3, that amount is defined as "the price at which property would change hands between a willing buyer and a willing seller ... with both parties having reasonable knowledge of the relevant facts." Although the IRS will not be bound by any Agreement, in order for the business value to be "pegged" for tax purposes:

- The price must be either fixed or easily determinable by a formula
- The agreement must not be a device to simply pass business interests for less than fair value; it must be a true business agreement
- The obligation to sell must be binding during lifetime

HOW IS THE BUSINESS VALUE DETERMINED?

It is wise to seek professional advice when valuing a business. There are a number of different ways to value a business, and the subtleties of valuing a business are outside the scope of this Q&A. Each particular situation is different; however, in general a business can be valued by:

- Market Approach – The business is compared to a publicly traded business and then the value is adjusted accordingly. Finding a publicly traded company that can compare with a privately held company can be a problem with this approach.
- Income Approach – The valuation is determined either by looking at the history of earnings or cash flow for the company and dividing by a capitalization rate for that industry (Capitalized Returns), or projecting future earnings for the company and applying a discount to determine the present value of that income stream (Discounted Future Returns Method).
- Asset Approach – The valuation is based on the underlying assets of the company and their value. In general the valuation is based on the value of the assets minus the liabilities, with an adjustment for the type of business.
- Owner's Estimate – The simplest method, it is the price that the owner agrees is a fair price for the business.

Buy-Sell Funding *Toolkit*



WHO ARE THE PROFESSIONALS THAT SHOULD ASSIST IN DEVELOPING A FUNDED BUY-SELL AGREEMENT?

At least three professionals should be part of the Buy-Sell Funding process.

- First, a competent Attorney fluent in Buy-Sell as well as estate planning issues is needed.
- Second, an Accountant familiar with the company and the business marketplace of the company is needed.
- Third, a Financial Advisor well versed in the use of life and disability insurance to fund the Buy-Sell Agreements is needed.

This is vital. Without the insurance, the surviving owners may not have the means necessary to fund the agreement. All three should be made well aware of the goals and expectations of all of the owners, their families and heirs.

Information contained here is based on current tax guidance and is subject to change.

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