Using Life Insurance to Fund a Buy-sell Agreement

A chief concern among businesses is how the death of an owner will affect the business, other owners and the heirs of the deceased. Surviving owners want to ensure the continuity of ownership, the protection of the business's finances and that their family is financially secure and compensated fairly in the event something happens to them.

What is a Buy-sell Agreement?

A buy-sell agreement is a contract among business owners that, upon the death of one of the owners, requires the remaining owners or the company itself to purchase the deceased's interest according to agreed upon terms of the contract. In addition, the deceased's heirs are required to comply by selling their inherited interest at a previously agreed-upon price.

The best way to fund a buy-sell agreement is through life insurance. This ensures that funds are immediately available when a death occurs. Also, death benefit proceeds are generally income tax-free; the funds used to buy the deceased's share are generally purchased for pennies on the dollar.

Buy-sell agreements have a number of key advantages:

- Establish a valuation of a deceased owner's interest in the business for estate tax purposes
- Establish a mutually agreeable price and terms to reduce potential future litigation or friction
- Help facilitate a smooth transition of management
- Ensure that the family of the deceased receives cash instead of unmarketable stock
- Protect the company's liquidity needs at a potentially vulnerable time

Types of Buy-Sell Life Insurance Plans

There are also a wide variety of buy-sell agreements:

Cross purchase plans: Each owner purchases a life insurance policy on the other owners and is a named beneficiary of the policy. Upon the death of an owner, each surviving owner receives the life insurance proceeds income tax free and uses the proceeds to purchase the deceased's business interest. The heirs of the deceased receive an agreed-upon payment for their inherited business interest.

Entity plans: The company purchases life insurance policies on each owner, naming itself as sole beneficiary. Upon the death of an owner, the company receives the life insurance proceeds and uses said proceeds to purchase the deceased's business interest. The heirs of the deceased receive an agreed-upon payment for their inherited business interest.

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Huckaby & Associates understands the complexities of buy-sell insurance policies and we are here to help you protect your business, your assets and your family. Contact us today for more information.