Buy-sell strategy for businesses with multiple owners

When there are multiple owners of a business, an entity purchase buy-sell may make sense, especially if the owners are different ages and in different health.

How does this strategy work?

A buy-sell agreement is a contract that provides for the future sale of a business interest, typically between the existing owners of the business. In an entity purchase buy-sell agreement, the business purchases life insurance policies on the lives of each of the co-owners. The business pays the annual premiums and is the owner and beneficiary of the policies. Because the business owns the policies, the policy cash values can be shown as an asset on its books.

When one owner dies, the business uses the life insurance proceeds to purchase the business interest from the deceased owner’s estate, thus giving each surviving owner a larger share of the business.

Benefits of this strategy:

• Easy to administer – Only one policy per person needs to be purchased.
• Equalization of payments – Since the business pays the insurance premiums, each owner, in essence, pays the same amount for each policy.
• Cash value is a business asset – The policy’s cash value will show up on the business’s balance sheet as an asset.

Considerations to keep in mind:

• The policies and cash value are subject to creditors of the business.
• Life insurance premiums are not tax-deductible for the business.
• The life insurance proceeds may increase the value of the business for estate tax purposes. This amount may be offset by the business’s obligation to buy the shares.
Strategy in action

• Jessica, Kate, Myra and Emily are all 25% owners in Acme Operations. Their business has been appraised at $8 million. They want to establish a buy-sell agreement so that the other owners could continue the business if one of them passes away.

• Acme Operations buys a $2 million life insurance policy on each owner. The business owns the policy, pays the premiums and is named beneficiary.

Myra unexpectedly passes away a few years later…

• Acme Operations receives the tax-free life insurance benefit of $2 million.

• It divides Myra’s business shares among the remaining owners. Now Jessica, Kate and Emily each own one-third of the business.

Prospective client

• Business with multiple owners.

• Wants a way to ensure that the business will continue if one of the owners passes away; wants to keep business ownership among the current owners.

• Wants to keep the administration of the buy-sell agreement easy, despite having multiple owners.

• Would like additional business assets on the books.