ADVANCED PLANNING

Business Strategies

Entity Purchase Arrangement for Partnerships & Limited Liability Companies
Enabling You to Decide Where Your Business Interest Goes

Every successful business should have a business continuation plan. Life insurance can help you provide the funds to build a successful strategy and foster and maintain financial wellness.

DO YOU IDENTIFY WITH THE FOLLOWING?

You are a business owner who:

- Has invested a lot of time and energy in your business to create value in the company, which is a major asset or the main asset in your estate.
- Would like to create a ready market for the sale of your business at your death, disability, or retirement.
- Wants to see that the business remains in the hands of the surviving partners or family members.
- Sees the need to establish an estate value for your business interest in order to reduce the potential for IRS disputes.
- Wants to be certain funds will be available to help with the buyout of a deceased owner's interest.

IF SO, YOU MAY WANT TO CONSIDER ESTABLISHING AN ENTITY PURCHASE BUY-SELL ARRANGEMENT FUNDED WITH LIFE INSURANCE. AN ENTITY PURCHASE BUY-SELL ARRANGEMENT IS:

- A contract between the owners of the business requiring the business to purchase the interest of an owner under specified terms and conditions.
- An arrangement that, when funded with life insurance, helps ensure that cash will be available to help with the buyout.

BENEFITS TO THE DEPARTING OWNER OR HEIRS

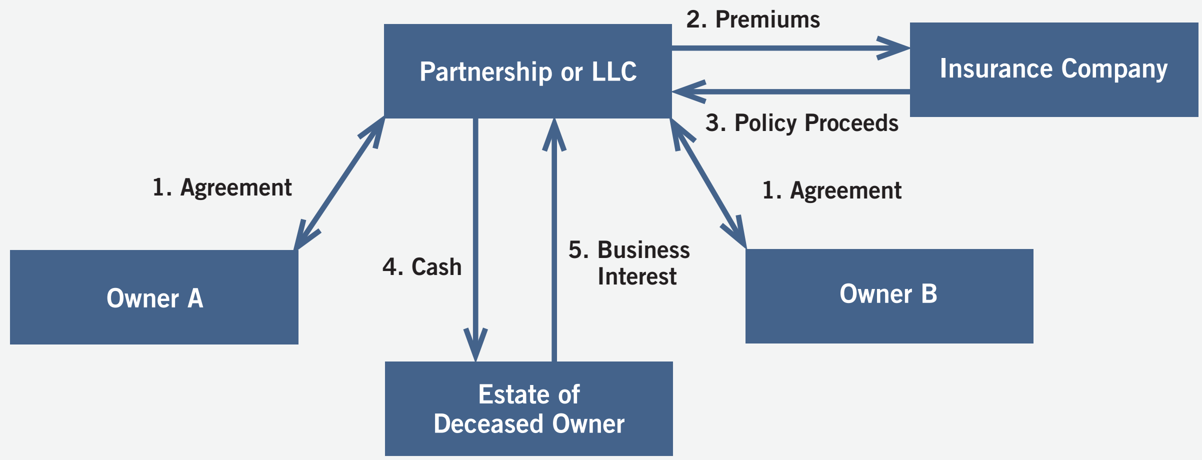
- If properly drafted, implemented, and maintained, the arrangement helps to establish the business value for estate tax purposes.
- It provides a ready market for the sale of the business interest.
- It ensures that cash to help pay estate taxes and/or to meet family needs will be available.
- The heirs are relieved of further business responsibilities.
- Where life insurance is used to fund the buyout, the heirs of the deceased owner immediately receive cash, avoiding delays and potential liquidation losses.

BENEFITS TO THE BUSINESS AND REMAINING OWNERS

- The business receives life insurance proceeds to finance the buyout of the deceased owner at the exact time when they are needed.
- The business continues uninterrupted with the surviving partners/members as owners.
- An entity purchase agreement funded with permanent life insurance can provide needed cash to help meet the contractual obligations established by the agreement, potentially minimizing the impact on working capital and cash flow.
- In contrast to a cross-purchase agreement, an entity purchase agreement funded with life insurance allows the business to purchase just one policy on each owner.
- Employees, creditors, and suppliers feel more secure knowing the business has a succession arrangement in place.
- Where permanent policies are purchased, any policy cash values are assets of the business that are reflected on the balance sheet and are available for business needs.[1]

[1] Life insurance policy cash values are accessed through withdrawals and policy loans. Loans are at interest. Loans and withdrawals may cause a reduction in cash values and death benefits, may affect any guarantees against lapse, and may have tax consequences.

HOW DOES AN ENTITY PURCHASE BUY-SELL ARRANGEMENT WORK?



1	The partnership or LLC enters into an entity purchase agreement with each business owner, obligating the business to purchase the deceased owner's interest in the business and obligating the decedent's estate to sell.
2	The partnership or LLC purchases life insurance protection on the life of each business owner equal to at least the value of the owner's interest. The business is the owner, premium payer, and beneficiary of each policy. You should consult your legal counsel to determine whether notice and consent under IRC §101(j) is required before the policies are issued in order to receive tax-favored treatment.[2]
3	At the death of an owner, the business collects the life insurance policy proceeds from the insurance company.
4	The business pays the agreed-upon amount, determined by the terms of the agreement, to the owner's estate.
5	The owner's estate releases the partnership or LLC interest to the business.

[2] Life insurance death proceeds are generally received income tax-free [IRC §101(a)]. For employer-owned contracts issued after August 17, 2006, death proceeds will be subject to income tax. However, where specific employee notice and consent requirements are met and certain exceptions apply, death proceeds can be received income tax-free [IRC §101(j)].

TAX CONSIDERATIONS

- For employer-owned life insurance policies issued after August 17, 2006, IRC §101(j) provides that death proceeds will be subject to income tax; however, where specific employee notice and consent requirements are met and certain safe harbor exceptions apply, death proceeds can be received income tax-free. Life insurance proceeds are generally received income tax-free under IRC §101(a).

Note: Where the entity is a limited liability company (LLC), the assumption is made that the entity will be taxed under partnership rules for federal tax purposes.

- Life insurance premiums are not deductible and lower the basis of the owners to whom the expense is allocated (as determined by the partnership or LLC agreement). However, where life insurance is used as a funding vehicle in a partnership, death benefit proceeds received by the business entity increase the surviving owners' basis in the business interest. Because high basis in a partnership shelters future distributions from income taxation, the use of life insurance can be an important planning technique. The amount of basis increase the surviving owners receive depends on a number of factors. Consult your legal, accounting, and tax advisors for a complete discussion.

- Where the partnership/LLC owns a life insurance policy on a partner/member, it is important that the insured has no "incidents of ownership" under IRC §2042. If an insured retains incidents of ownership, policy proceeds may be included in his/her estate. Although regulations exist dealing with incidents of ownership in the shareholder context, no such regulations are found in the partnership taxation area. Based on revenue rulings, private letter rulings, and case law, the general belief is that where the partnership is both the owner and beneficiary of a policy on a partner's life, the partner's gross estate includes just his/her share of the partnership interest (the value that reflects his/her proportionate share of the death proceeds). Furthermore, where the partner is a majority owner, the conservative planning position is to include provisions in the partnership agreement that prevent the insured from exercising any power over the policy.

- Unlike IRC §302 stock redemptions, not all liquidations done in a partnership context will result exclusively in capital gains tax treatment to the withdrawing partner. IRC §736 liquidation rules determine the tax effect when a retiring or deceased partner receives a distribution or distributions from the business in a complete liquidation of his or her interest. The tax implications of IRC §736 depend on whether "hot assets" (IRC §751 assets: unrealized receivables, substantially appreciated inventory) are present in the partnership; whether the payments are made in cash or non-cash property; whether an IRC §754 "step-up" election is present; and whether the partnership is primarily a service provider where capital is not a material income-producing factor.

The possibility of ordinary income treatment on a redemption/liquidation exists primarily for service-oriented partnerships such as general partnerships involving the practice of medicine, dentistry, law, accounting, etc.

Partnership distribution rules are complex and you should consult your tax and legal advisors before implementing any type of an entity purchase arrangement.

RECOMMENDED ACTION PLAN

1. Seek the professional advice of your attorney regarding your personal needs and objectives for the disposition of your business interest.
2. Meet with your accountant, attorney, and/or professional appraiser to determine the value of your business interest.
3. Determine the appropriate insurance solution.
4. Have your attorney draft the entity purchase agreement and other appropriate documents.
5. Apply for the life insurance to be owned by the business and complete all medical and underwriting requirements.
6. Review the buy-sell arrangement with your licensed financial professional, attorney, and accountant on a regular basis.