Fixed index universal life insurance

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Allianz Life Insurance Company of North America

Buy-sell agreements

Ensuring the continuity of your business

Buy-sell agreements help ensure the smooth continuation of your business after a potentially disruptive event, such as the death of a partner.

BUY-SELL AGREEMENTS CAN **PLAY A VITAL PART** in your overall business strategy.

A buy-sell agreement is a legally binding contract that, when exercised, allows a business entity, shareholder, or partner to purchase an interest in the business when an owner leaves or dies, or for any other specified event. Typically, buy-sell agreements specify when, to whom, and at what price an interest in the business will be sold.

Before you set up a buy-sell agreement, you should consult a tax advisor and attorney for guidance on your unique situation. To work as intended, buy-sell agreements must be drafted carefully.

Benefits of a buy-sell agreement

When properly structured, buy-sell agreements can help ensure a smooth transition for and continuation of your business.

- A buy-sell agreement may be a good fit if you have a specific business succession strategy in mind, or if you want to prevent outsiders from getting control of your business.
- Having a buy-sell agreement may also be reassuring to your creditors, customers, and employees.
- Such an agreement could even help safeguard the value of your business and support its entity status (if your company is an S corporation or a limited liability company, for example).
- In some cases, buy-sell agreements may also help prevent unexpected estate-tax consequences upon the business owner's death. Buy-sell agreements allow you to fix the purchase price as the estate-tax value of a deceased owner's business interest, which may help you avoid future valuation problems with the IRS.

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Must be accompanied by the "Understanding fixed index universal life insurance" consumer brochure or appropriate product consumer brochure.

Product and feature availability may vary by state and broker/dealer.

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Setting up the buy-sell agreement

Your attorney might advise that to be valid, buy-sell agreements must clearly specify the conditions under which the interest in the business will be sold. This includes listing events that will trigger the buy-sell agreement, such as:

- Death of a bus owner
- Retirement, resignation, or termination of a partner or shareholder
- Long-term disability
- Legal, personal, or financial problems

Though it's designed as a contingency strategy, YOU SHOULD **PLAN YOUR BUY-SELL AGREEMENT** IN DETAIL.

After you've determined the "trigger events," you'll need to establish a purchase price. An independent business valuator can help you determine the fair market value of your business.

Although it may be tempting to guess at a figure or skip this step, it's critical in preventing potential disputes or unintended tax consequences down the road. Also, keep in mind that valuations may need to be updated periodically.

To be successful, there must be funds available to carry out the terms of a buy-sell agreement.

Although a buy-sell agreement is usually a contingency strategy, you should consider how you and your business partner(s) would be able to execute the agreement, if needed. Without a funding strategy in place, the buyer(s) could be forced to take out a loan, sell assets, or perhaps even declare bankruptcy.

Fortunately, there are several ways to fund a buy-sell agreement, such as using cash, redeeming stock, or drafting an installment note. Depending on the size of your business – and your liquid assets – one of these options could be a good choice.

But if you don't have the necessary funds, there is another option you can consider.

Fixed index universal life insurance (FIUL) can give you and your business partners death benefit protection, to help address business continuation needs and the surviving family's needs for income, final expenses, estate taxes, and debt replacement. Depending on your situation, an FIUL may be a good choice to fund your buy-sell agreement because the death benefit provides cash only when it's needed. This allows the remaining business owner to buy the company interests of a co-owner's share, if he or she were to die, at a previously agreed-upon price.

There are many reasons why FIUL can be a good choice to fund your entity purchase buy-sell agreement, including the following:

- A death benefit is provided at the time when it is needed to carry out the buy-sell agreement – upon the death of the business owner.
- In most cases the death benefit will be income-tax-free.
- Potential cash value accumulation is income-tax-deferred.
- Any cash value accumulation could be accessed through tax-free loans or withdrawals[1] to fund the buy-sell upon other triggering events, such as the insured's disability or retirement.
- When taking policy loans, it is important to carefully manage your policy values to help prevent a lapse.

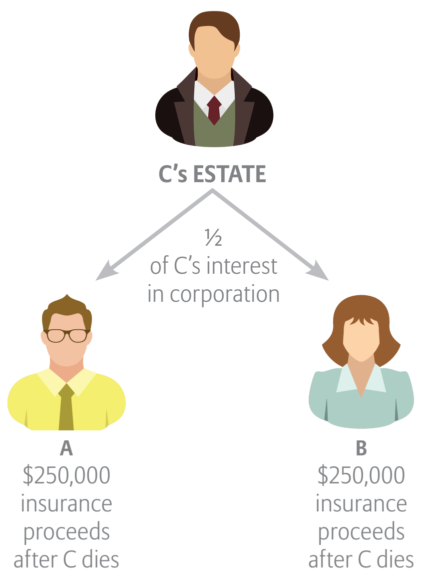
Since life insurance is an underwritten product, any strategy that includes it is contingent on the health underwriting and financial underwriting of the insured.

[1] Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy. If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change and you should consult a tax professional.

Multiple ways that life insurance can fund the buy-sell agreement

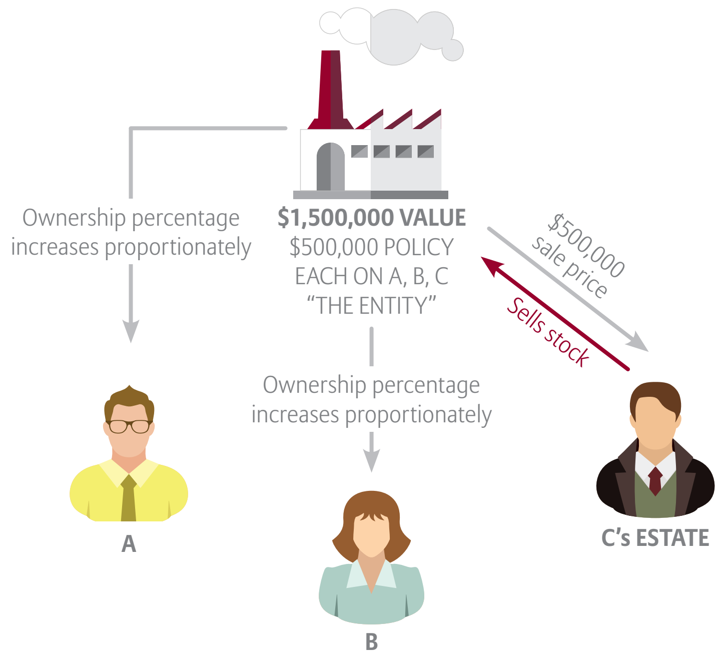
Cross-purchase agreement: Each business owner buys and is the beneficiary of a life insurance policy on the other shareholders. Upon the death of the first owner, the remaining shareholders receive the death benefit from the life insurance policy(ies).

In this hypothetical example,[1] the ABC Corp is valued at $1,500,000. Shareholders A, B, and C each have a one-third ownership of $500,000 in the business. Each shareholder buys a $250,000 life insurance policy on the other two (so, in total, six policies are purchased). If shareholder C were to pass away, shareholders A and B would each use the death benefit from their $250,000 policies on C's life to buy out C's interest in the corporation.



Entity purchase (stock redemption) agreement: This may be more appropriate for larger companies that have more shareholders. In an entity purchase agreement, the business purchases only one policy per owner – in this example shareholders A, B, and C in equal shares. Upon death of the owner, in this example shareholder C, the business collects the death benefit from the policy and uses it to "buy the owner out" by making a liquidation payment to his or her estate, as shown in this hypothetical example:[1]

If your business is a C corporation, the receipt of death benefits may increase the corporation's liability for the Alternative Minimum Tax. You should consult a tax professional about your unique circumstances.



Talk to your financial professional about how life insurance can be an important part of your business-continuation strategy.

[1] This hypothetical example is provided for illustrative purposes only. It does not depict an actual buy-sell agreement, nor is it intended to serve as a model for establishing such an agreement.

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An employer-owned life insurance policy may be subject to the requirements of Internal Revenue Code 101(j) in order to obtain an income-tax-free death benefit. In general those rules require that before the policy is issued, the employer must provide the insured with a written notice of the life insurance and obtain a written consent from the insured. Consult with an attorney for application of those rules to a specific situation.

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