Business Planning

American General
Life Companies

Buy-Sell Agreement

CONCEPT APPLIED:
A buy-sell agreement ensures stability in business transition and prevents heirs from having to run or sell the business after an owner dies. With a buyer in place, a life insurance policy assures that funds will be available when needed.

HOW IT WORKS:
There are three main types of buy-sell agreements:

Cross-purchase agreement—each owner buys part of the interest. Each owner buys insurance on every other owner to fund the purchase.

Entity-purchase agreement—the business itself buys the interest. The business buys insurance on each owner to fund the purchase.

One-way agreement—an individual (usually a key employee) agrees to buy a sole-owner business. The buyer typically purchases life insurance on the owner to fund the purchase.

WHY IS IT USEFUL?
A buy-sell agreement ensures an orderly transition and alleviates conflicts over the value of a business. Heirs get needed cash, and surviving owners are assured that the heirs or a stranger cannot insert themselves into the business.

50 words or less

A buy-sell agreement is a legally binding contract—whether simple or complex—that dictates the terms of an unplanned future sale of a business interest, ensuring continuity of ownership and management. It specifies the triggering circumstances (retirement, death, disability), the buyer(s), and how the business will be valued.

BUY-SELL AGREEMENT

TRIGGER EVENT

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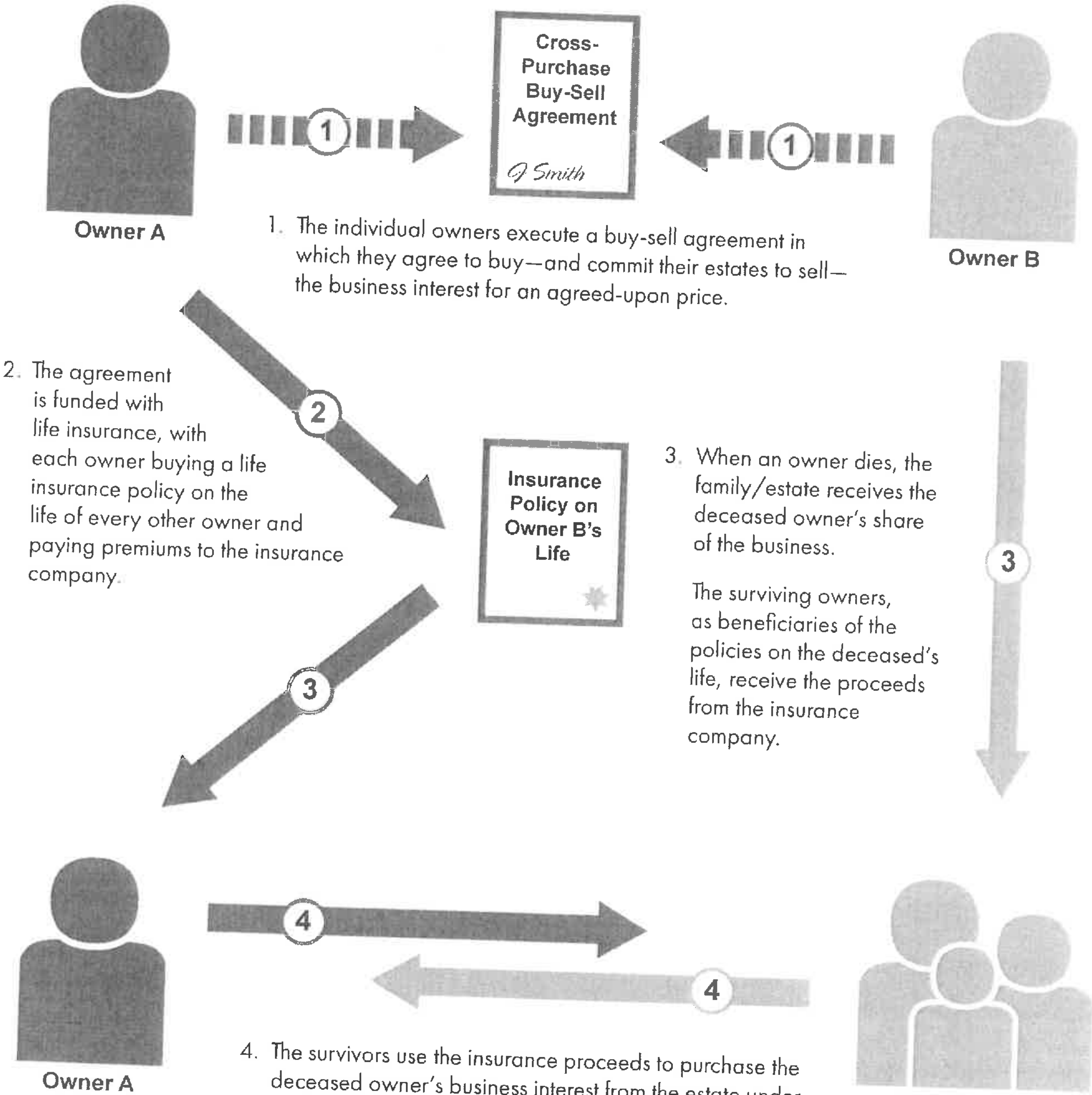
TRANSFER OF BUSINESS OWNERSHIP

- BUSINESS CONTINUATION ✓
- INCOME TO PURCHASE INTEREST ✓
- CUSTOMER ASSURANCE IN BUSINESS ✓
- COMFORT FOR EMPLOYEES ✓
- NO STRANGERS OR DISGRUNTLED HEIR OWNERS ✓

CROSS-PURCHASE BUY-SELL AGREEMENT



1. The individual owners execute a buy-sell agreement in which they agree to buy—and commit their estates to sell—the business interest for an agreed-upon price.

2. The agreement is funded with life insurance, with each owner buying a life insurance policy on the life of every other owner and paying premiums to the insurance company.

3. When an owner dies, the family/estate receives the deceased owner's share of the business.

   The surviving owners, as beneficiaries of the policies on the deceased's life, receive the proceeds from the insurance company.

4. The survivors use the insurance proceeds to purchase the deceased owner's business interest from the estate under the terms of the agreement.

Your Business - A Most Valuable Asset

As a business owner, you might agree that plenty of time was spent planning the birth of your business and building it into a going concern. Less time is generally devoted to developing business continuation strategies and contingency plans. That's understandable. Day to day business activities and *"what if"* questions typically focus on competition, consumers, government regulation, profit margins and the like.

But what if something happened to you? What if you died unexpectedly? What problems would that create for your heirs, for surviving owners and for the business itself? Here are some business continuation concerns you may want to consider:

- If you died last night, would your family be able to step in and replace your skills and ability and if not, would they need the money you've invested in the business?
- Would your business be able to continue after providing heirs with the money they deserve?
- If your co-owner died, are you prepared to share management decisions with his/her heirs and do they have his/her skills and ability?

The bottom line is: *Will there be a smooth transition of business ownership and will your family's financial future be protected?*

The Buy-Sell Agreement

A Buy-Sell Agreement, which is a contract between business owners or the business, is a way to plan for contingencies. It works like this - at the death (and perhaps total disability) of an owner, his/her business interest is transferred according to the contract terms. The other owner(s) or the business is obligated to purchase the deceased's business interest and the deceased's estate is obligated to sell. It helps benefit business owner's heirs by:

- Freeing them of business worries.
- Establishing a fair price for the business.
- Eliminating the possibility of a forced sale.
- Avoid probate delays.

And it also helps benefit the surviving owner(s) by:

- Setting the purchase price for the business interest.
- Allowing for uninterrupted control of the business.
- Providing some assurances to clients and creditors that the business will continue *"as usual."*

This assumes that the agreement is properly funded.

Funding the Buy-Sell Agreement

Money will be needed to carry out the terms of the business Buy-Sell Agreement. Without proper funding, the Buy-Sell Agreement may not be worth much more than the paper it is printed on. Several funding options are available:

- ***Wait and Pay Cash*** - The surviving owner(s) or the business uses cash to fund the agreement. *Viable, provided that cash will be there when it's needed.*
- ***Wait and Borrow Funds*** - The surviving owner(s) or the business borrows funds, usually through bank loans, to fund the agreement. *Viable, provided a lender is available and the buyer can afford to pay back the loan including the loan interest.*
- ***Life Insurance*** - Insurance policies are purchased on the lives of the business owners. *Viable, provided the business owners are insurable.*

Buy-Sell Funding with Life Insurance

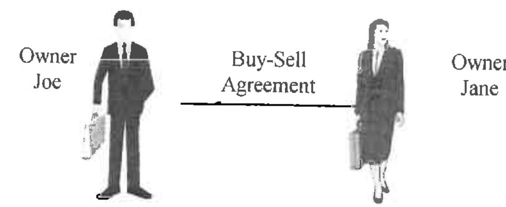
Using life insurance as a funding vehicle could be the most cost effective option. It provides these benefits:

- Proceeds are available when death occurs.
- Proceeds are generally income tax free.
- Premiums may be lower than the cost of repaying interest on a loan.

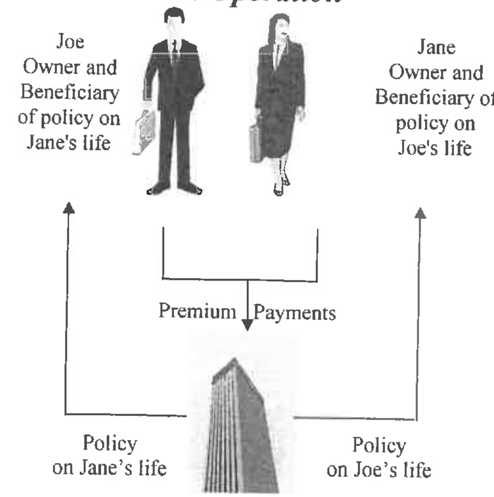
Buy-Sell Agreements can be structured in a variety of ways. One of the most popular for businesses with one to three owners is the cross purchase plan. This method, including funding with life insurance, is illustrated on the next panel. Another popular Buy-Sell form is where the business purchases the deceased's interest. This form is not illustrated.

Note: The example presented in this brochure is an oversimplification. Federal income tax and estate tax aspects have not been addressed. You should always consult with your tax professional regarding your particular situation.

The Arrangement



In Operation



Insurance Company
(issues policies on the lives of Joe and Jane)

At Business Owner's (Joe) Death