

Agent's Guide to Buy-Sell Agreement Review



The death, disability, severe illness or retirement of a controlling owner of a business can wreak havoc on the entity that the owner may have spent a lifetime building. If not adequately planned for, such events can lead to a forced sale of the business out of family control.

Advantages of a Properly Structured Buy-Sell Agreement

Advantages of a Buy-Sell Agreement

- Helps create a market for a closely held business.
- Assures continuation of business that owners worked hard to create.
- Establishes a purchase price for each owner's interest in the business and if the agreement is between non family members may be used to establish the value of the business for estate planning purposes.
- Restricts outsiders from obtaining an interest in the business or control of the business.
- Allows co-owners the ability to purchase the exiting owner's interest.
- Insurance death benefit provides estate liquidity and cash to beneficiaries not involved in the business.
- Cash value in insurance policy provides means of paying for interest if owner becomes disabled, retires or leaves business.
- Serves to avoid family disputes.
- Avoids disruption of the business after an owner's death.



Buy-Sell Agreements can provide one of the most orderly means of transferring a business interest upon the death, disability, withdrawal or retirement of an owner. However, Buy-Sell Agreements must be funded to be of use. An agreement without a means to pay for the stock does not help anyone. Life insurance is one of the most cost efficient and tax efficient means to fund a Buy-Sell Agreement. All concepts, strategies and products discussed in this literature may not be suitable for every client.

Disadvantages of a Buy-Sell Agreement

- The agreement must be funded to be effective.
- If insurance is used as the funding vehicle, premium payments must be made to keep the life insurance policy in force.

Why Should A Buy-Sell Agreement Be Reviewed?

1. The value of every company changes yearly. In order to reflect an accurate transition if the Buy-Sell is implemented, an accurate valuation is needed to avoid challenges to the Buy-Sell Agreement's legitimacy.
2. Goals may have changed since the initial implementation of the Buy-Sell Agreement.
3. Life insurance product features have changed dramatically over the past several years offering benefits which were previously unavailable such as coverage for terminal, critical and chronic illness.

Is A Buy-Sell Review Needed?

Does the current Buy-Sell plan...

Yes

No

...offer accelerated benefit options for terminal illness?

...offer accelerated benefit options for critical illness?

...offer accelerated benefit options for chronic illness?

...increase in value as your business value increases?

...pay an income tax free lump sum at the death of an owner?

...offer to continue paying premiums automatically during a disability?

...offer a stream of income that may supplement retirement income of an owner?

...offer a stream of income to buy out an owner?

If any of these questions were answered “no”, your client should obtain a no cost Buy-Sell Review.



Sample Family Business Buy-Sell Planning

PRE - Retirement

Goal: Transfer business to Child if Parent becomes incapacitated or dies during active working years.
Parent's retirement age = 70.

Initial Business Value: \$1,000,000 **Ownership:** Parent = 80%, Child = 20%.

| Age | End Of Policy Year | Premium Outlay | Cash From Policy | Accumulation Value | Surrender Value Death Benefit | Death Benefit |
|-----|--------------------|----------------|------------------|--------------------|-------------------------------|---------------|
| 51 | 1 | 40,000 | 0 | 31,563 | 4,123 | 831,563 |
| 52 | 2 | 40,000 | 0 | 64,975 | 40,279 | 864,975 |
| 53 | 3 | 40,000 | 0 | 100,224 | 78,272 | 900,224 |
| 54 | 4 | 40,000 | 0 | 137,372 | 118,164 | 937,372 |
| 55 | 5 | 40,000 | 0 | 176,634 | 160,170 | 976,634 |
| 56 | 6 | 40,000 | 0 | 218,217 | 204,497 | 1,018,217 |
| 57 | 7 | 40,000 | 0 | 262,367 | 251,391 | 1,062,367 |
| 58 | 8 | 40,000 | 0 | 309,307 | 301,075 | 1,109,307 |
| 59 | 9 | 40,000 | 0 | 359,174 | 353,686 | 1,159,174 |
| 60 | 10 | 40,000 | 0 | 412,126 | 409,382 | 1,212,126 |
| | | 400,000 | 0 | | | |
| 61 | 11 | 40,000 | 0 | 483,911 | 483,911 | 1,283,911 |
| 62 | 12 | 40,000 | 0 | 561,421 | 561,421 | 1,361,421 |
| 63 | 13 | 40,000 | 0 | 644,924 | 644,924 | 1,444,924 |
| 64 | 14 | 40,000 | 0 | 734,770 | 734,770 | 1,515,865 |
| 65 | 15 | 40,000 | 0 | 831,547 | 831,547 | 1,631,547 |
| 66 | 16 | 40,000 | 0 | 935,675 | 935,675 | 1,735,675 |
| 67 | 17 | 40,000 | 0 | 1,047,862 | 1,047,862 | 1,847,862 |
| 68 | 18 | 40,000 | 0 | 1,168,746 | 1,168,746 | 1,968,746 |
| 69 | 19 | 40,000 | 0 | 1,298,834 | 1,298,834 | 2,098,834 |
| 70 | 20 | 40,000 | 0 | 1,438,961 | 1,438,961 | 2,238,961 |
| | | 800,000 | 0 | | | |

1. Premium Outlay = \$40,000 Annual Premium for 20 years (\$800,000 total)
2. Cash from Policy = -0- during Pre-Retirement years.
3. Non-guaranteed assumptions: ANICO Indexed Universal Life¹ As of 4/01/12, Male, Age 50, Preferred TNU, 100% Indexed Allocations.
4. Accumulation Value = value growing inside the contract.
5. Surrender Value = value accessible at the end of each policy year.
6. Death Benefit = amount of income tax free benefit paid at insured's death. During pre-retirement years, the death benefit increases to account for increases in business value. Increase is not a one for one increase with business value.

¹ Form Series IUL08, IULU08 (Forms will vary by state) The ANICO Indexed Universal Life Insurance policy is not a registered security or stock market investment and does not directly participate in any stock or equity investment or index. When an individual purchases the policy, the individual is not buying an ownership interest in any stock or index

Sample Family Business Buy-Sell Planning

Retirement

Goal: Transfer business to Child if Parent becomes incapacitated or dies during Parent's retirement years.
Parent's retirement age = 70.

Initial Business Value: \$1,000,000 **Ownership:** Parent = 80%, Child = 20%.

| Age | End Of Policy Year | Premium Outlay | Cash From Policy | Accumulation Value | Surrender Value Death Benefit | Death Benefit |
|-----|--------------------|----------------|---------------------------------------|--------------------|-------------------------------|---------------|
| 71 | 21 | 0 | 175,000 | 1,549,910 | 1,367,122 | 2,056,174 |
| 72 | 22 | 0 | 175,000 | 1,670,173 | 1,296,464 | 1,865,252 |
| 73 | 23 | 0 | 175,000 | 1,801,080 | 1,227,954 | 1,665,834 |
| 74 | 24 | 0 | 175,000 | 1,944,122 | 1,162,704 | 1,457,543 |
| 75 | 25 | 0 | 175,000 | 2,100,991 | 1,102,012 | 1,239,982 |
| 76 | 26 | 0 | 175,000 | 2,272,916 | 1,046,695 | 1,160,340 |
| 77 | 27 | 0 | 175,000 | 2,458,791 | 995,215 | 1,118,155 |
| 78 | 28 | 0 | 175,000 | 2,659,547 | 948,055 | 1,081,033 |
| 79 | 29 | 0 | 175,000 | 2,876,293 | 905,852 | 1,049,667 |
| 80 | 30 | 0 | 175,000 | 3,110,214 | 869,301 | 1,024,812 |
| | | 800,000 | Total Outlay Pre-Retirement | 1,750,000 | | |
| 81 | 31 | 0 | 175,000 | 3,362,570 | 839,149 | 1,007,277 |
| 82 | 32 | 0 | 175,000 | 3,634,707 | 816,206 | 997,941 |
| 83 | 33 | 0 | 175,000 | 3,927,910 | 801,199 | 997,594 |
| 84 | 34 | 0 | 175,000 | 4,243,808 | 795,171 | 1,007,361 |
| 85 | 35 | 0 | 175,000 | 4,583,960 | 799,071 | 1,028,269 |
| | | 800,000 | Retirement Total Distributions | 2,625,000 | | |

- Premium Outlay = -0- Annual Premium in Retirement Years
- Cash from Policy = \$175,000 to Parent for 15 years (\$2,625,000 total) for retirement supplement and/or buy out of Parent's ownership in Business.
- Non-guaranteed assumptions: ANICO Indexed Universal Life¹ As of 4/01/12, Male, Age 50, Preferred TNU, 100% Indexed Allocations.
- Accumulation Value = value growing inside the contract
- Surrender Value = value accessible at the end of each policy year
- Death Benefit = amount of income tax free benefit paid at insured's death. During retirement years, the death benefit is changed to a level benefit as Parent's business interest ceases to grow during buy out phase.

But wait... what happens if the Parent becomes incapacitated due to a severe illness during the working years or during retirement years?

Life Altering Occurrence Example – Age 60 Pre-Retirement

Illness – Terminal, Critical or Chronic Illness Riders may be exercised to generate cash flow for business expenses, buy out options or personal cash flow. Refer to chart below for estimates.

Disability – Waiver of Stipulated Premium² pays for the entire \$40,000 premium to Parent’s retirement year age 70.

Death – Death Benefit paid to beneficiary (Child) who will then pay for stock of deceased Parent thereby completing transfer of business to Child. Parent may designate recipients of buy out proceeds through will or trust.

| Chronic and Critical Illness | | | | |
|------------------------------|-------------------|---------------------|-------------------|------------------|
| Attained Age | Slight Impairment | Moderate Impairment | Severe Impairment | Terminal Illness |
| 55 | \$160,170 | \$471,938 | \$783,705 | \$883,015 |
| 60 | \$409,382 | \$691,090 | \$972,797 | \$1,096,053 |
| 65 | \$831,547 | \$1,070,563 | \$1,309,578 | \$1,475,483 |
| 70 | \$1,438,961 | \$1,618,136 | \$1,797,312 | \$2,024,982 |

Life Altering Occurrence Example – Age 80 Retirement

Illness – Terminal, Critical or Chronic Illness Riders may be exercised to generate cash flow for business expenses, buy out options or personal cash flow. Refer to chart below for estimates.

Cash from Policy – projected to pay \$175,000 annually for 15 years (\$2,625,000 total) to supplement Parent’s retirement income and fund buy out of Parent’s business interests thereby transferring Parent’s business interest to Child.

Death – Death Benefit paid to beneficiary (Child) who will then pay for remaining stock of deceased parent thereby completing transfer of business to Child. Parent may designate recipients of buy out proceeds through will or trust. Death Benefit is in addition to the \$1,750,000 in distributions already paid from policy.

| Chronic and Critical Illness | | | | |
|------------------------------|-------------------|---------------------|-------------------|------------------|
| Attained Age | Slight Impairment | Moderate Impairment | Severe Impairment | Terminal Illness |
| 75 | \$1,102,012 | \$1,102,012 | \$1,102,012 | \$1,102,012 |
| 80 | \$869,301 | \$869,301 | \$869,301 | \$869,301 |
| 85 | \$799,071 | \$799,071 | \$799,071 | \$799,071 |
| 90 | \$2,001,546 | \$2,001,546 | \$2,001,546 | \$2,001,546 |

² Waiver of Stipulated Premium Form Series PWSTP, PWSTPU (Forms will vary by state).

Accelerated Benefit Riders

From ANICO

Access policy's death benefit while insured is still living...



**Three
great living
benefits
for No
Additional
Premium³ ...**

Terminal – provides for the payment of an accelerated benefit if an eligible insured has an illness or chronic condition that is expected to result in **Death Within 24 Months**.⁴

Critical – provides for the payment of an accelerated benefit if an eligible insured experiences a critical illness. Covered critical illness includes **16 Different Illnesses**.⁴

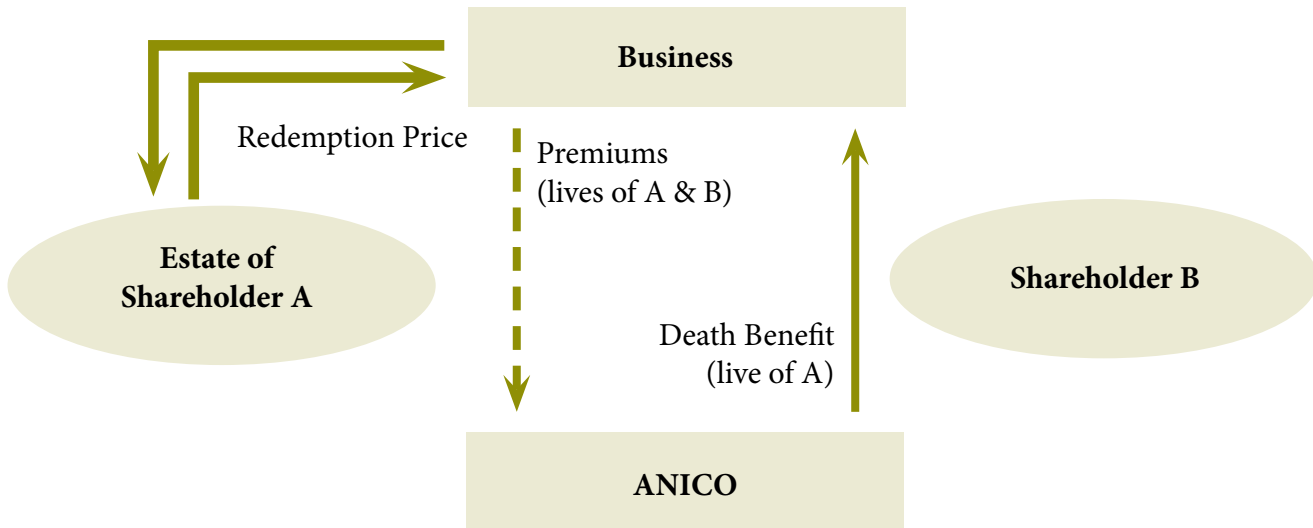
Chronic – provides for the payment of an accelerated benefit if an eligible insured is unable to perform two out of six activities of daily living (**2 of 6 ADLs**)⁴ or is cognitively impaired.

³ The Accelerated Benefit Riders are offered for no additional premium; however, the accelerated benefit payment will be less than the death benefit because it is paid prior to the death of the Insured and it is reduced by an administrative fee that is assessed when accelerated benefits are elected.

⁴ Refer to Rider forms for a complete list of illnesses and definitions. Some states may limit the definition of terminal illness to conditions that are expected to result in death within 12 months. All riders may not be available in all states. Form Series ABR11-TM, ABR11-CH, ABR11-CT (Forms will vary by state).

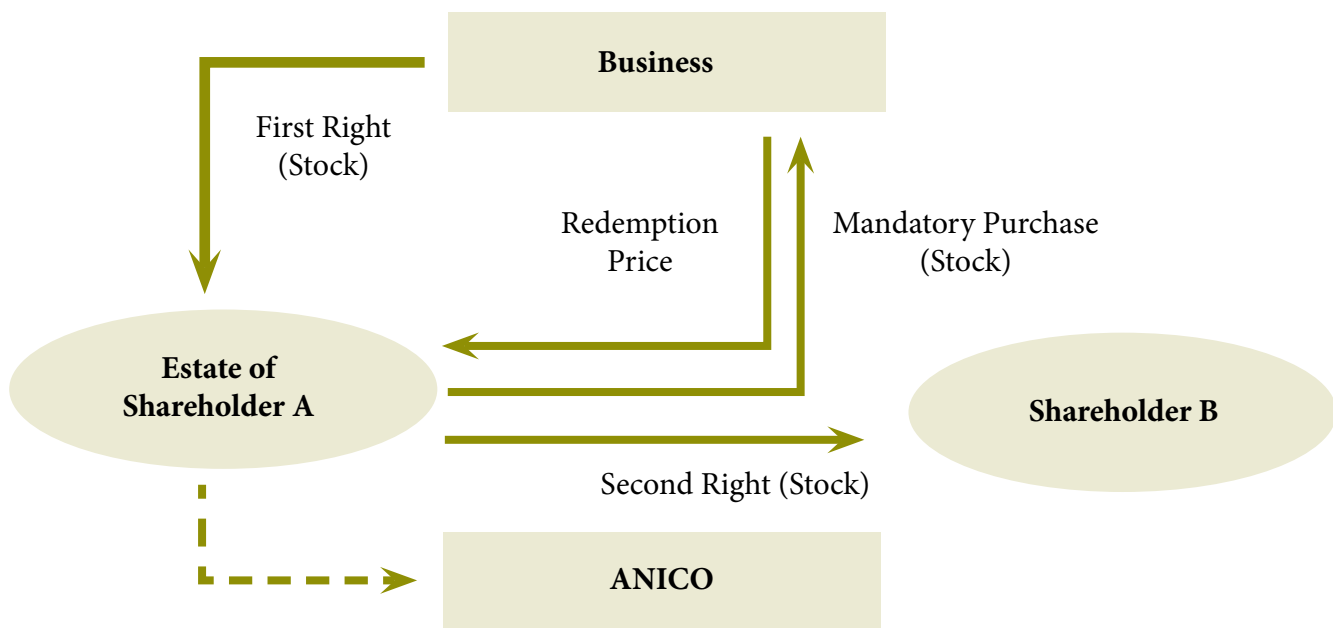
Types of Buy-Sell Agreements

Entity Purchase Buy-Sell Agreements



An **Entity Purchase Buy-Sell Arrangement** (or "stock redemption arrangement") is an arrangement among the owners and the entity. The entity agrees to purchase (or redeem) all of the interest of a deceased owner and the owners agree to sell their interests to the entity.

Wait and See Buy-Sell Agreements

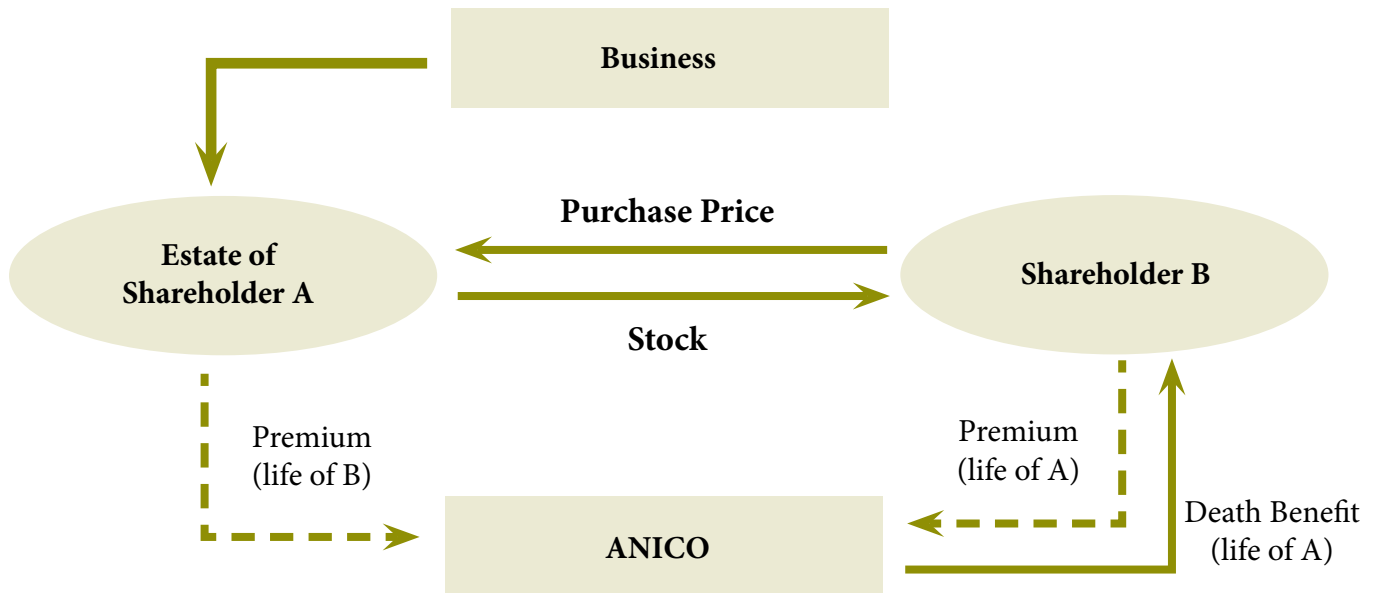


(Policies owned by either the Business or the Shareholders.)

A **Wait and See Buy-Sell Arrangement** is a hybrid arrangement combining the features of both the entity purchase Buy-Sell Arrangement and the cross-purchase Buy-Sell Arrangement. A wait and see Buy-Sell Arrangement generally gives the entity the option (or "right of refusal") to buy any portion of the deceased owner's interest within a certain time period after the owner's death. If the entity does not fully exercise the option, the remaining owner's have the second right of refusal. Finally, if the remaining owners do not exercise their right of refusal, then the entity must redeem the balance of the deceased owner's interest. Depending upon how the arrangement is funded and whether the entity or the surviving owner's acquire the deceased owner's interest, the arrangement will function as either an entity redemption or a cross-purchase arrangement.

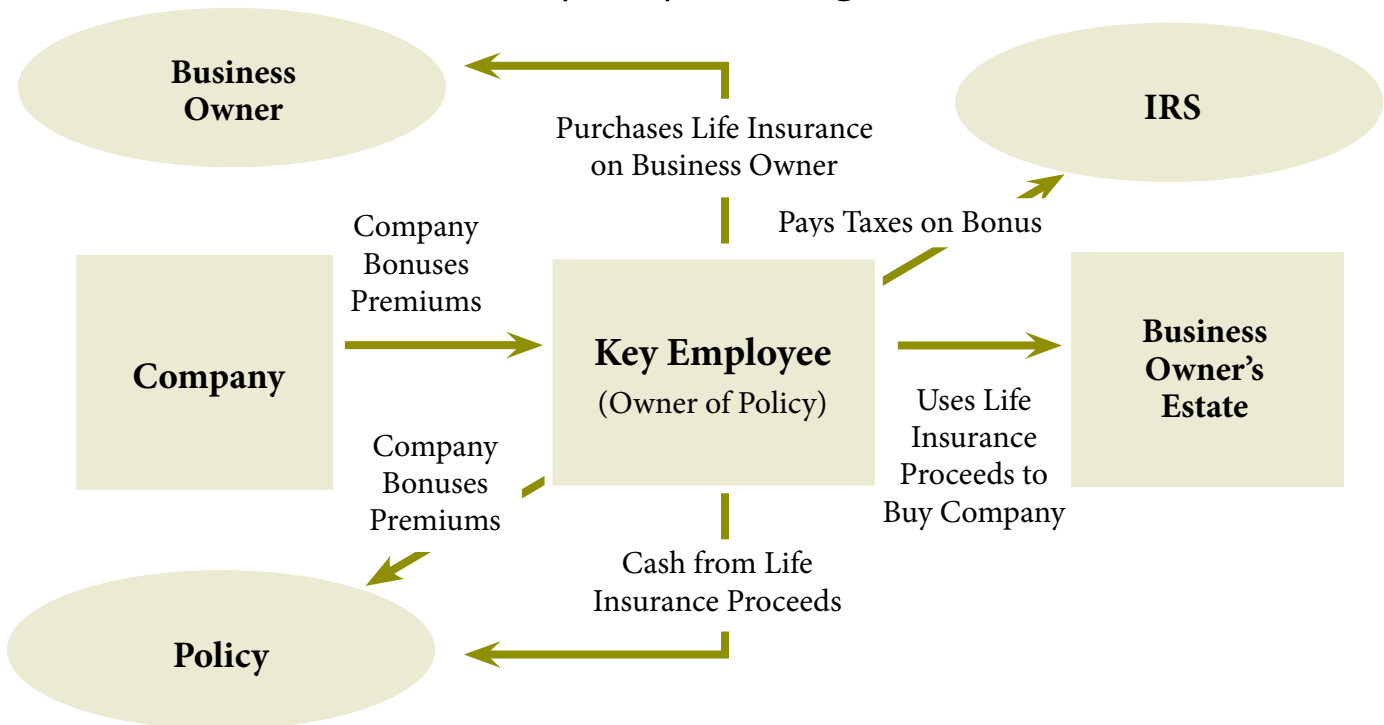
Types of Buy-Sell Agreements

Cross Purchase Buy-Sell Agreements



In a **Cross-Purchase Buy-Sell Arrangement** the owners (or their estates) are obligated to sell their interests to each other. The entity is not a party to the arrangement.

One-Way Buy-Sell Agreements



A **One-Way Buy-Sell Arrangement** is a type of a Buy-Sell Arrangement in which a valued employee, who may be a family member or a key person in the business, will purchase and own a life insurance policy on the life of the business owner. In this situation, because there is generally only one business owner and one designated successor, only one life insurance policy is required to fund the arrangement. The valued employee, who may be a family member or a colleague, will also be the beneficiary of the life insurance policy. The company will pay a bonus to the successor/policy owner in the amount of the premium payments annually to minimize the out-of-pocket expense of the arrangement. The bonus payments may be tax-deductible to the corporation when they are paid, but the payment will also be taxable to the recipient.

What Type of Coverage Should Be Purchased?

Term Life Insurance

Term life insurance is pure insurance protection that pays a predetermined sum if the insured dies during a specified period of time. On the death of the insured, term insurance pays the face value of the policy to the named beneficiary. All premiums paid are used to cover the cost of insurance protection.

The term may be one, five, 10, 20 years or longer. But, unless renewed, the insurance coverage ends when the term of the policy expires. Since this is temporary insurance coverage it is the least expensive to acquire. Here are the main characteristics of term life insurance:

- Temporary insurance protection.
- Low cost.
- No cash value.
- Level death benefit.
- Usually renewable.
- Sometimes convertible to permanent life insurance.



Permanent Life Insurance

Permanent life insurance provides lifetime insurance protection (does not expire), but the premiums must be paid on time. Most permanent policies offer a savings component combined with the insurance coverage. This component, in turn, causes premiums to be higher than those of term insurance. The savings component may offer a fixed interest rate or may be in the form of an indexed rate related to the performance of the S&P 500®. This savings portion of the policy allows the policy owner to build cash value within the policy which can be distributed at some time in the future.

Here are the main characteristics of permanent life insurance:

- Permanent insurance protection.
- More expensive to own.
- Builds cash value.
- May have increasing death benefit.
- Tax free loans are permitted against the policy.⁵
- Favorable tax treatment of policy earnings.
- Level premiums.

For a comprehensive Buy-Sell solution, Permanent Life should be selected to enable the policy owner to utilize the cash value during retirement years as a buy out distribution to the retiring business owner.

⁵ Loans are subject to interest charges and can reduce the death benefit paid to beneficiaries. Outstanding loans may affect the policy's death benefit, the value of the policy and possibly the length of time the policy remains in force.

Standard pocket with business card die cut.
Do not print dotted line.

Neither American National nor its representatives provide legal or tax advice. Individuals should speak with their attorney or tax advisor for answers to their specific questions.



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