



PROTECTING THE BUSINESS

Buy-Sell Agreements Comparison Chart for C Corporations

	Cross-Purchase	Stock Redemption
Parties to the Arrangement	Agreement between or among individual shareholders.	Agreement between corporation and its shareholders.
Policy Ownership and Beneficiary Designation	Each individual shareholder is the applicant, owner, premium payer, and beneficiary of policy(ies) on his/her co-shareholder(s). If corporation pays the premiums, they must be treated as additional compensation or as stockholder dividends.	The corporation is the applicant, policy owner, premium payer, and beneficiary of policy on each shareholder.
Number of Policies	Multiple policies required: Formula for number of policies is $n(n-1)$, where n = number of shareholders.	Easier to administer since only one policy needed for each shareholder.
Funding Obligation <i>(a) Premium Payment</i>	Nondeductible after-tax outlay to shareholder/policy owner, but properly structured bonus/compensation arrangement may defray all or most of the premium burden.	Nondeductible expense; cash value considered corporate asset, thereby reducing cost to that extent.
<i>(b) Payment of Business Purchase Price</i>	Any shortfall after insurance payable from personal funds of surviving shareholder(s).	Amount in excess of insurance proceeds payable by corporation from general assets.
Income Tax Basis of Stock <i>(a) Deceased Shareholder(s)</i>	Shares receive basis step-up to fair market value.*	Same as cross-purchase. Stock receives stepped up basis at death (no capital gain).
<i>(b) Surviving Shareholder(s)</i>	Acquired shares receive basis equal to purchase price.	Basis remains unchanged, but percentage of stock ownership increases. Lifetime sale afterward may result in larger taxable gain.
Tax Brackets	If individual's tax bracket is higher than employer's, creates higher after-tax cost of insurance.	If corporate tax bracket lower than shareholders', more dollars available to pay insurance premiums.
Legality of Arrangement Under State Law	Not applicable.	State law may restrict corporate right to redeem its stock due to inadequate surplus. Receipt of life insurance proceeds may alleviate problem.
Family Attribution Rules	Not applicable.	Redemption may be dividend rather than sale due to ownership by related persons, estate beneficiaries, trust, partnership, or another corporation.

*Under current law, estate tax is repealed for 2010 and no step-up in basis on death in that year.

	Cross-Purchase	Stock Redemption
Accumulated Earnings Tax	Not applicable.	Penalty for accumulating more than for “reasonable business needs.” No accumulated earnings tax problem if business purpose can be established for maintaining cash value policy(ies). Death benefits (less cash value) may trigger Alternative Minimum Tax for C corporations.
Transfer for Value <i>(a) At Death of Shareholder</i>	Estate of deceased owns policy(ies) on surviving shareholder(s). Estate must sell policy(ies) to respective insured(s), the corporation, or another exempt party in order to avoid “transfer for value” rule.	No need to transfer policy(ies) to surviving shareholder(s).
<i>(b) Change of Buy-Sell Arrangement</i>	<i>To Stock Redemption:</i> generally no violation of “transfer for value” rule since insured(s) is (are) shareholder(s) and, generally, officer(s) of the corporation (transferee).	<i>To Cross-Purchase:</i> Problematic if transfer of policy ownership or beneficial interest is made to, or in favor of, co-shareholder(s), and the transferee is not one of the exempt parties.
Change in Stock Ownership Percentage	Actual purchases by surviving shareholder(s) determine ownership percentage and control of corporation.	Ownership by surviving shareholder(s) changes on pro rata basis following redemption. Unintentional shift in voting power can result.
Claims of Creditors	Creditors of shareholder who owns and is beneficiary of policy may attach cash values and/or death benefits.	Cash values and/or death benefits are corporate assets and subject to claims by creditors.
COLI - Best Practices	Corporate-owned life insurance policy notice, consent and reporting requirements of IRC §§ 101(j) and 6039I may apply depending upon whether the shareholder owning the policy is deemed to own more than 50% of the corporation.	Corporation must follow notice, consent and annual reporting requirements for corporate-owned policies per IRC §§ 101(j) and 6039I.

This chart highlights some of the factors that may impact the choice between the two commonly used buy-sell arrangements—cross-purchase and stock redemption—funded with life insurance, using a C corporation. Note that wait-and-see or other optional purchase buy-sell agreements are hybrids of the cross-purchase and stock redemption agreements.

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