



Buy-Sell Planning Using Life Insurance

Cross Purchase Agreements

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Cross Purchase Agreements

Using Life Insurance

As a successful business owner you do not like surprises – especially when it comes to money.

That's why it is important to plan for unexpected events that may affect your business. Have you thought about what would happen to the business if one of your co-owners were to die? Where would you get the money to fund the buyout of his or her share of the business?

Cross Purchase Agreements are one way you can help ensure the continued success of your business so that you can focus on what you do best -- take care of business.

Cross Purchase Agreements

In a cross purchase agreement, business owners agree among themselves to collectively purchase the interest of any owner who dies. Using life insurance policies on each other to fund the buyout, each business owner purchases a life insurance policy on all the other owners. At the death of an owner, the surviving owners receive the policy proceeds and then purchase a pro rata share of the deceased owner's business interest from his or her estate. The result is that the estate's non-liquid business interest has been converted into cash and the surviving owners now own 100 percent of the business.



Leaving my business to chance just isn't my style.

Advantages

- **Income-tax-free death benefit:** Life insurance proceeds normally will be received income-tax-free (IRC § 101 (a)). This assumes there are no transfer-for-value issues.
- **Policies and cash values generally are not subject to the entity's creditors:** Because the policies are not owned by the entity, the policies are not business assets and therefore are not subject to claims of the business' creditors.
- **Basis increase:** In a cross purchase plan, the purchaser (surviving shareholder) will receive full basis credit for the purchase of the stock.
- **No corporate Alternative Minimum Tax:** Corporate AMT applies only to C-corporations. Because the owners (rather than the corporation) own the policies, the policy proceeds are not subject to the corporate AMT.
- **Capital gains treatment:** Sale of stock by an owner's estate normally will be considered the sale of a capital asset and receive capital gains tax treatment. Even better, there usually is little or no capital gains to be recognized because of the step-up in basis of the business interest to its fair market value at the death of an owner (IRC § 1014).

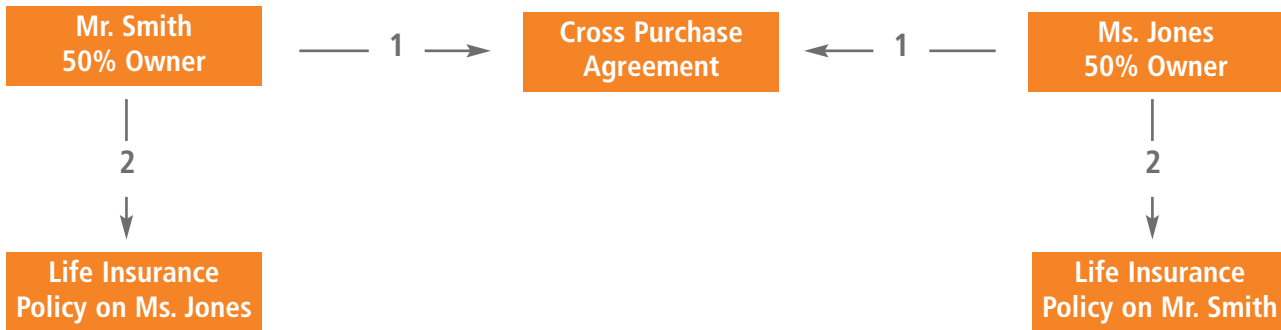
Disadvantages

- **Use of personal income:** Personal after-tax funds are used to purchase the insurance policies and the premiums are not deductible. A split dollar arrangement between the company and each owner could assist the owner in paying the insurance premiums.¹
- **Possible disproportional premium payments:** In a cross purchase agreement, the policies are cross-owned. This means that the youngest owner (presumably the one who can least afford to pay) will own and pay for the policy on an older, and perhaps rated owner. Again, a split dollar arrangement can be used to help equalize the premium payments.¹
- The timing of a triggering event can result in inequality of total benefits received between shareholders.
- **The company cannot record the policies as assets:** The entity does not own the insurance policies and therefore cannot book them as assets. However, if the policy is a split dollar arrangement, the company's security interest in the cash value is a business asset.
- **Administrative complexities:** In the case of more than two owners, multiple policies must be purchased and held by each owner. The formula is $N \times (N-1)$, where N = the number of owners. In the case of five owners, for example, 20 policies (5×4) need to be purchased.

¹ Split dollar arrangements are subject to Split Dollar Final Regulations issued by the IRS and Treasury that apply for purposes of federal income, employment and gift taxes.

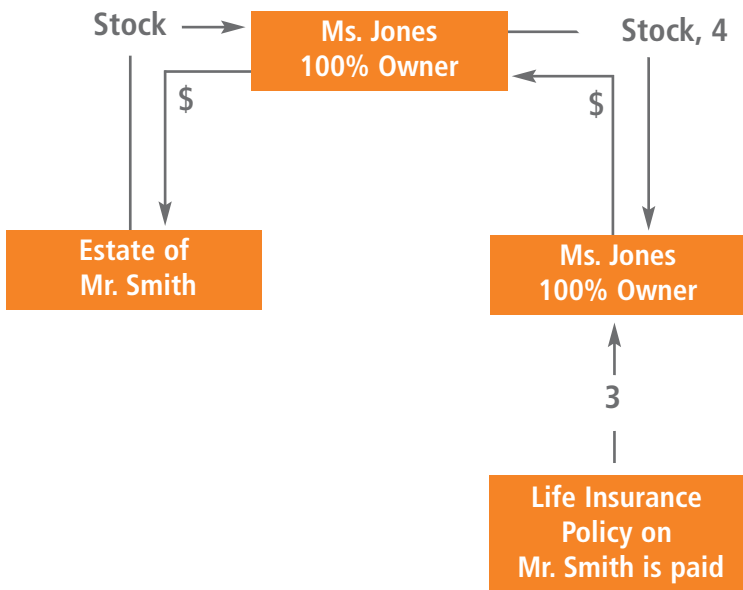
How It Works

Establishing and Funding the Plan



1. The owners of Smith-Jones Company establish a cross purchase agreement between themselves.
 2. Mr. Smith takes out a life insurance policy on Ms. Jones. Ms. Jones takes out an insurance policy on Mr. Smith.
- Each is the owner, beneficiary and premium payer of a life insurance policy on each of the other business owners.

At Death or Other Triggering Event



3. Assuming Mr. Smith dies, the life insurance company pays Ms. Jones the death benefit.
4. Ms. Jones uses this cash to purchase the business interest in Smith-Jones Company now belonging to Mr. Smith's estate.

Result

Surviving owner, Ms. Jones retains control of Smith-Jones Company and Mr. Smith's estate has cash in exchange for the business interest.

Next Steps

Designing a business continuation plan is a crucial step to ensure your business remains in-tact at your retirement, death or other triggering event. Whether you leave your business by choice or by chance, you'll leave your business on track and help provide for your family's future. With a cross purchase agreement, you can help protect the financial security of yourself, your business, co-owners and your family.

Talk to your ING Financial Professional to determine if a cross purchase agreement may meet your specific needs.



For more information, please call your
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