



Michael and Sarah Livingston

BUSINESS INSURANCE ANALYSIS
November 18, 2009

PREPARED BY:

Matthew Schulte, CLU, ChFC, CFP®
Suite 401
Conshohocken, PA 19428
(610) 684-1100

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Business Insurance Analysis

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Entity Purchase Agreement

In an entity purchase agreement (also known as a "Stock Redemption"), the business enters into an agreement with each owner to purchase the interest of any owner who dies. In this type of agreement the business purchases a life insurance contract on each owner. The amount of the insurance contract is equal to his/her respective interest in the business. At the death of any owner, the policy proceeds are paid to the business and the business uses those proceeds to acquire the stock of the deceased owner from their estate.

The table below will list some of the advantages and disadvantages of an entity purchase agreement funded with life insurance.

Advantages

- An entity purchase agreement can be administratively simple. The total number of life insurance contracts is equal to the total number of business owners.
- Any cash value built up inside of the insurance contracts are assets that can be listed on the balance sheet.
- Premiums are paid from the business, which removes the burden of the premiums having to be paid out of personal resources.
- Since the business pays the premiums in an entity purchase agreement, younger or healthier owners do not have to pay disproportional premiums for coverage on older or rated owners.

Disadvantages

- Life insurance proceeds payable to the business may increase the value of the business for estate tax purposes.
- Policy values are subject to attachment by the creditors of the business.
- Each surviving owner generally will not recognize an adjustment to their "owner's basis", despite the corresponding change in their personal interest in the business. (Pass-through entities are an exception.)
- The business cannot take a deduction for premium payments when the business is the beneficiary of the policy.
- Should an owner have more than a 50% ownership stake in the business, it would allow that owner to change beneficiaries (perhaps in violation of the agreement).

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Cross Purchase Agreement

In a cross purchase agreement, owners of a business agree to collectively purchase the interest of any owner who happens to die. Utilizing life insurance policies on each other to fund the buyout, each owner of the business purchases a life insurance contract on the lives of all the other owners. At the death of any owner, the surviving owners receive the policy proceeds and then purchase a pro rata share of the deceased owner's business interest from their estate. The result is that the non-liquid business interest of the deceased owner has been converted to cash for his/her heirs and the surviving owners now own 100 percent of the business.

The table below will list some of the advantages and disadvantages of an cross purchase agreement funded with life insurance.

Advantages

- The surviving partners/owners typically receive their life insurance proceeds income tax-free.
- Typically the contract cash values are not subject to the creditors of the business, since the contracts are owned personally.
- The sale of a deceased owners interest by the estate will usually be treated as a sale of a capital asset and therefore be given capital gains treatment.
- Traditionally in a corporate cross purchase agreement, the surviving owners will receive a basis increase for the purchase of the stock.

Disadvantages

- A cross purchase buy-sell agreement can become complex if you have a business with more than 2 or 3 owners, since each owner owns a policy on each of the other owners. A "trusted" buy-sell may eliminate this problem.
- The business cannot list the policies as assets of the company. Since the policies are individually owned, the business cannot book them as assets.
- Each business owner must generally use personal resources to purchase the insurance policies. Additionally, the premium payments are not deductible by the owner. The business, however, could fund the premiums as an additional benefit plan.
- The timing of a business owners death could result in inequality of total benefits received by the shareholders.
- There is the potential for disproportional premium payments among owners who are of different ages and health profiles.

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Funding Buy-Sell Agreements

Whether you pass control of a business to a new generation, to a co-owner, or to a key employee, an effective succession plan can ensure a smooth transfer of your business interest at death. A corporate buy-sell agreement should be funded by a method that will facilitate a worry-free transfer of a deceased partner's business interest to the surviving owner(s). When determining the appropriate funding method, you should look for the following characteristics:

- Relative low cost
- Easy to understand
- Easy to put in place and administer
- No adverse impact to the working capital or credit position of the business

Although the majority of buy-sell agreements are funded with life insurance, there are other methods that could be used to provide the liquidity to acquire a business interest. The most common alternatives in funding a buy-sell agreement are:

Sinking Fund

Dollars are earmarked and accumulated over time to purchase a business interest. When using business assets to create the sinking fund, you could run the risk of straining the company's working capital. The primary task with this method is that a premature death will leave surviving owners with insufficient cash to buy out the deceased owner's interest.

Borrowing

The business receives the needed funds from a bank or other lender and the seller is paid in full at the time of the deceased partner's death. The business repays the lender over time. This method requires the business to generate sufficient cash flows to make the required payments on the borrowed funds. The question may be, will the bank lend money to the business if the deceased owner was responsible for generating much of the company's revenue?

Installment Payments

An installment sale is often thought to be a feasible way to purchase a deceased owner's interest. This is similar to the borrowing approach, except that the seller finances the purchase. This places the seller in a precarious and less secure position. The seller will have to determine whether he/she is willing to be dependent upon the business without a hand in its management. A seller allowing the business to defer payments will expectedly insist on security for the unpaid amounts. While corporate assets can secure the unpaid balance, it may hinder the company's ability to borrow money or raise capital.

Life Insurance

Funding your buy-sell agreement with life insurance may be the most economical vehicle for ensuring that the necessary funds are available to purchase a deceased owner's interest. With life insurance as your funding vehicle, you can prepay the cost of the buyout with the proceeds coming to the business owner untaxed and on time. In summary, the following reasons are why life insurance is often considered the most effective option for funding your buy-sell agreement:

- Death proceeds guaranteed by premium payments
- Death proceeds are generally income tax free
- Cash values could be used for buyout at retirement or disability
- Discounted dollars often provides the most economical option
- Credit position of the business may be strengthened

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Your Business Interest

Many business owners have achieved success by working hard, taking risks and juggling a host of financial hurdles. Often times, a business owner's personal wealth is significantly tied to their business interests. This analysis will look at business entities where **Michael Livingston** has an ownership stake.

There is no such thing as an exact business valuation methodology. The more opinions you solicit, the more suggested methods you will receive. **We recommend that all business owners use a professional appraiser to suggest the most appropriate method for their unique situation.**

For this hypothetical analysis, we are going to look at **Geneitic Research, Inc.**, where the *assumed* value for the business today is **\$3,500,000**.

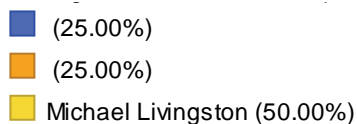
Total Business Value
Current Business Value
\$3,500,000
Future Business Value (2014)
\$5,636,785
Michael Livingston's Business Interest
Current Interest Value
\$1,750,000
Future Interest Value (2014)
\$2,818,393

This analysis **will** look at the impact of future growth on the assumed business value. You assume **Geneitic Research, Inc.** will grow at a rate of **10.00%** over the next 5 years. At that rate, the value of the business would be **\$5,636,785** in **2014**.

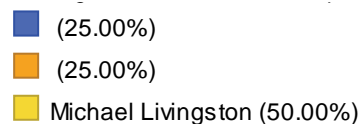
Your current interest in **Geneitic Research, Inc.** is **50.00%**, which represents **\$1,750,000** of its assumed current value. This represents **\$2,818,393** of the assumed future value in the year **2014**. This table defines the current ownership structure of the business:

Business Partner	Ownership Interest	Current Value	Future Value
Brian Johnson	25.00%	\$875,000	\$1,409,196
Sarah Livingston	25.00%	\$875,000	\$1,409,196
Michael Livingston	50.00%	\$1,750,000	\$2,818,393
Total Business Interest	100.00%	\$3,500,000	\$5,636,785

Current Interest



Future Interest



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Your Current Buyout Funding

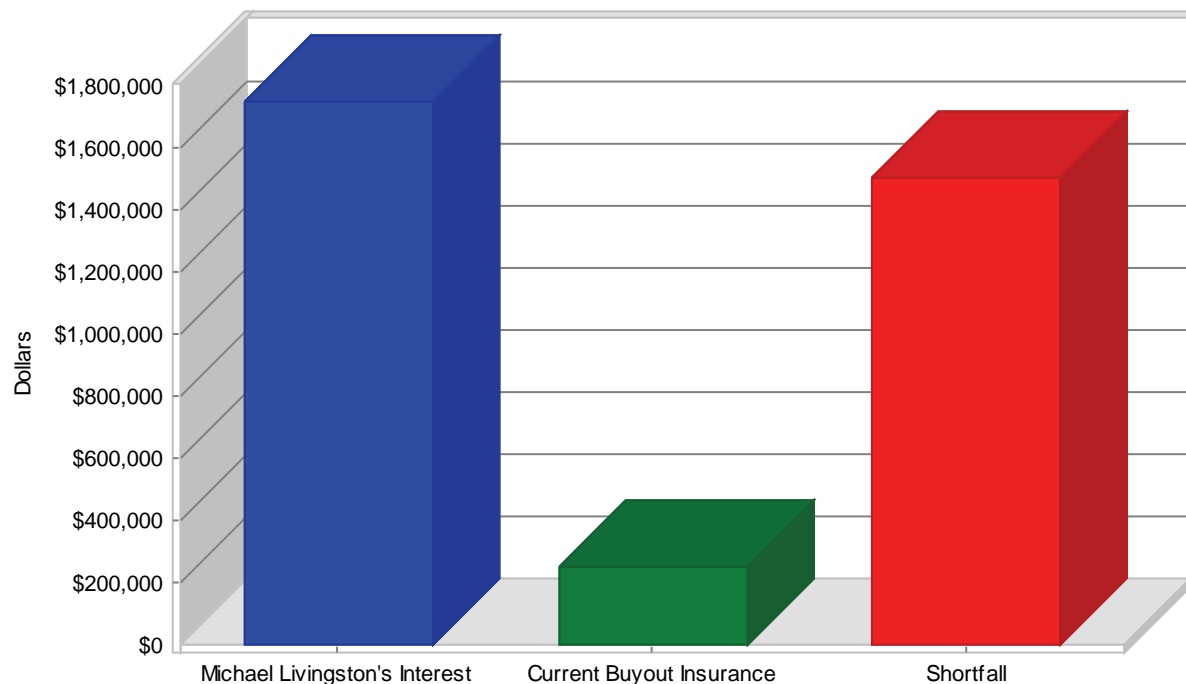
Business owners need a plan to help ensure that in the event of a premature death, their heirs will benefit from an agreed upon "buyout" of the deceased owner's business interest. Many people refer to a buy-sell agreement as a "will" for the business because it directs the timing, amount, and parties, involved for the disposition of the business interest.

Two common types of buy-sell agreements are the "Cross Purchase" (Owners of a business collectively agree to a "buyout" of the deceased owner's interest) and the "Entity Purchase" (the business itself has an agreement with each owner for the business to perform a "buyout" of a deceased owner's interest). Buy-sell agreements are often funded with life insurance policies, so lets look at what existing life insurance coverage you may already have targeted to a "buyout" at **Michael Livingston's** death.

Current Business Interest Michael Livingston's Current Interest	\$1,750,000
Business's Buyout Insurance	\$250,000
Business Associate's Buyout Insurance	\$0
Shortfall	\$1,500,000

Currently, the assumed total value of **Geneitic Research, Inc.** is **\$3,500,000** and **Michael Livingston's** share of that is **\$1,750,000**. There is a total of **\$250,000** in existing life insurance death benefit on **Michael Livingston's** life that is owned by the business. There is a total of **\$0** in existing life insurance death benefits on **Michael Livingston's** life that is owned by the other business associates. These death benefit proceeds are assumed to be used for the purpose providing the cash necessary to buy out **Michael Livingston's** interest in the business.

Current Buyout Insurance



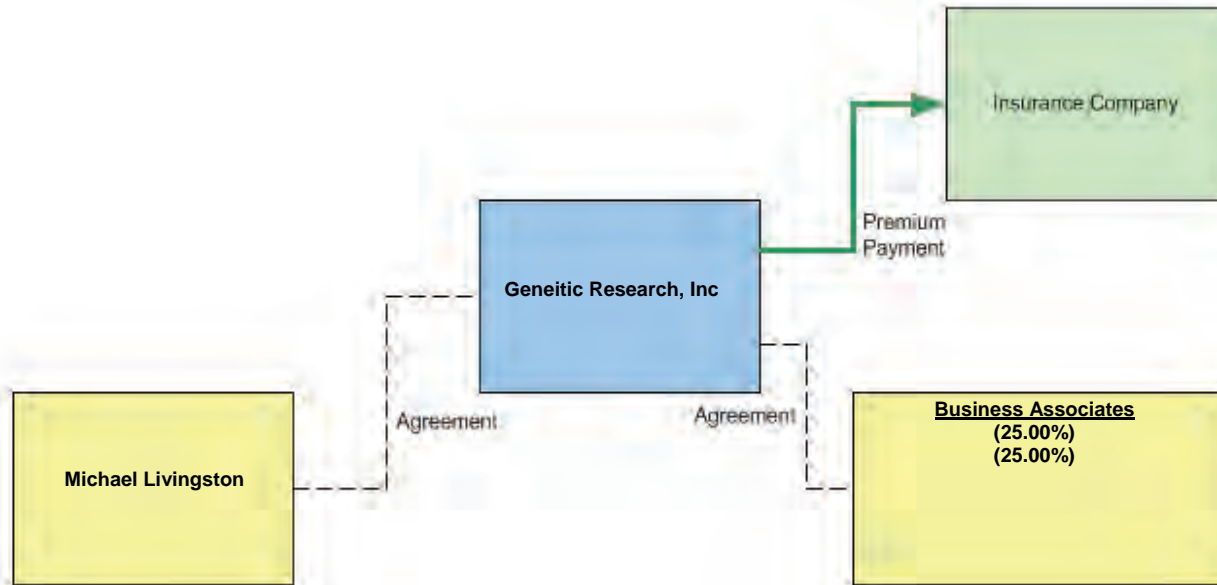
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Entity Purchase Agreement Diagram

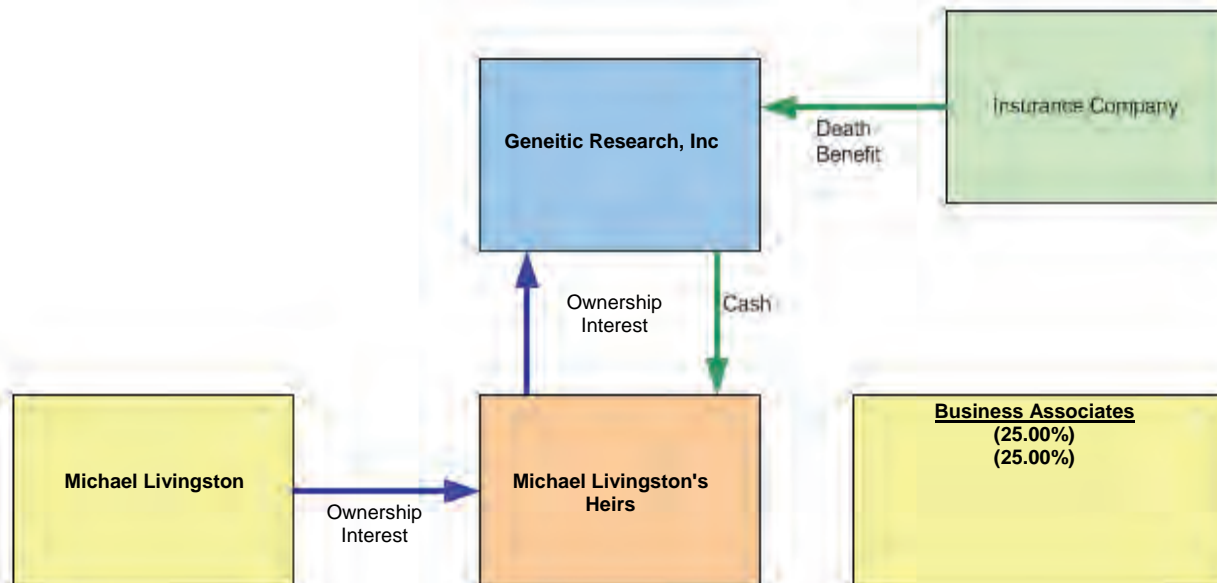
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In the diagram below, we see how such an agreement would be structured for **Geneitic Research, Inc.**. The diagram shows how this agreement functions in relation to **Michael Livingston**, both prior to and after death.

Entity Purchase Agreement Diagram



Entity Purchase Agreement Diagram



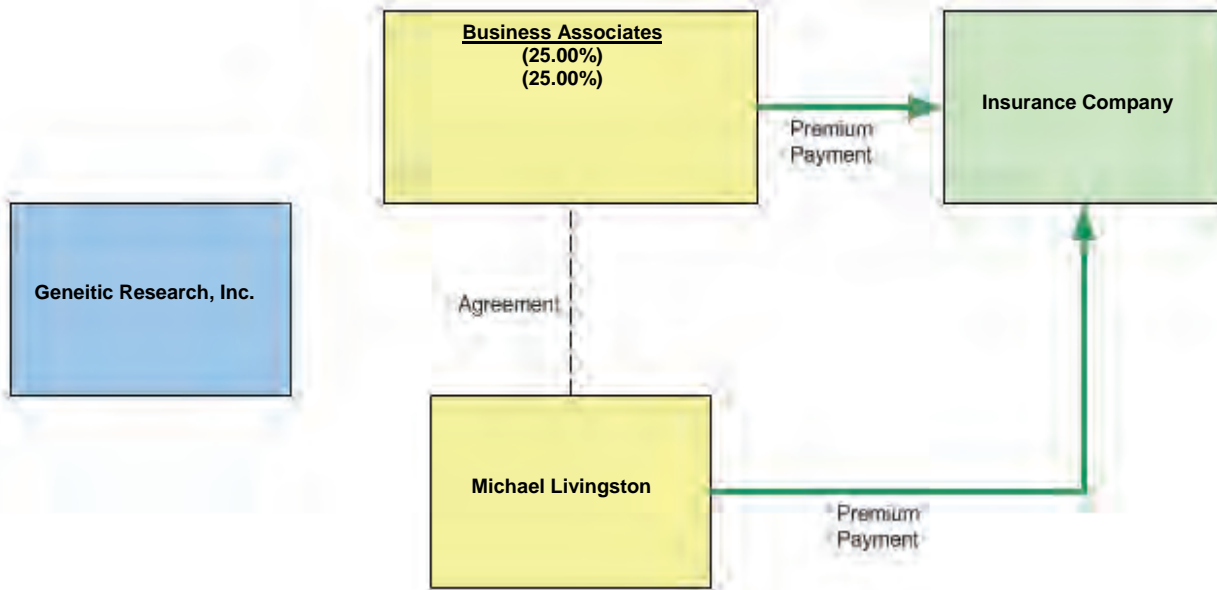
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Cross Purchase Agreement Diagram

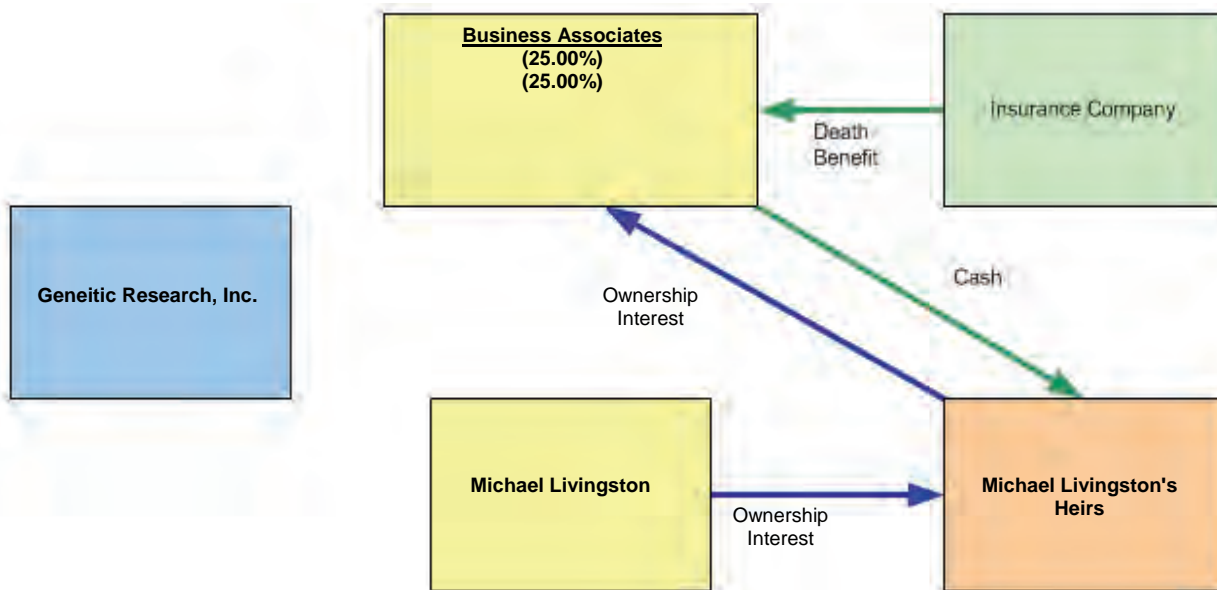
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In the diagram below, we see how such an agreement would be structured for **Geneitic Research, Inc.** The diagram shows how this agreement functions in relation to **Michael Livingston**, both prior to and after death.

Cross Purchase Agreement Diagram



Cross Purchase Agreement Diagram



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Buy Sell Agreement

When life insurance is used as the funding vehicle for a buy-sell agreement, the number of policies and the amounts of each policy will differ based upon whether you are using a Cross Purchase or an Entity Purchase agreement. This report outlines the specific details for each hypothetical policy for **both** a cross purchase and an entity purchase agreement.

Buy Sell Agreement

Insured	Policy Owner/Beneficiary	Today	Future
Sarah Livingston	Geneitic Research, Inc.	\$875,000	\$1,409,196
Brian Johnson	Geneitic Research, Inc.	\$875,000	\$1,409,196
Michael Livingston	Geneitic Research, Inc.	\$1,750,000	\$2,818,393
Total		\$3,500,000	\$5,636,785

Buy Sell Agreement

Insured	Policy Owner/Beneficiary	Today	Future
	Michael Livingston	\$583,333	\$939,464
Total		\$875,000	\$1,409,196

Insured	Policy Owner/Beneficiary	Today	Future
	Michael Livingston	\$583,333	\$939,464
Total		\$875,000	\$1,409,196

Insured	Policy Owner/Beneficiary	Today	Future
Michael Livingston	Sarah Livingston	\$875,000	\$1,409,197
Michael Livingston	Brian Johnson	\$875,000	\$1,409,197
Total		\$1,750,000	\$2,818,393

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Information Summary

The following financial information and assumptions were used in the preparation of this analysis.

Family Information

Client: Michael and Sarah Livingston
Address: *Not Available*

Client: Michael Livingston	Spouse: Sarah Livingston
Date of Birth: 1/1/1965	Date of Birth: 1/1/1965
Current Age: 44	Current Age: 44

Children	Gender	Age	Date of Birth
Gloria Livingston	Female	14	1/1/1995
Mitchell Livingston	Male	9	1/1/2000

Information Summary

Basic Assumptions

Analysis For: Michael Livingston
Business Name: Genetic Research, Inc.
Business Value: \$3,500,000
Growth Rate: 10.00%
Growth Period: 5

Business Ownership

Business Partner	Ownership Interest	Current Value	Future Value
Sarah Livingston	25.00%	\$875,000	\$1,409,196
Brian Johnson	25.00%	\$875,000	\$1,409,196
Michael Livingston	50.00%	\$1,750,000	\$2,818,393
Total Business Interest	100.00%	\$3,500,000	\$5,636,785

Current Buyout Insurance

Insurance Policy	Owner	Benefit Amount
<i>(Insurance Owned by Company)</i>	Genetic Research, Inc.	\$250,000
<i>(Insurance Owned by Other Business Partners)</i>	Business Associates	\$0
Total Buyout Coverage:		\$250,000

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