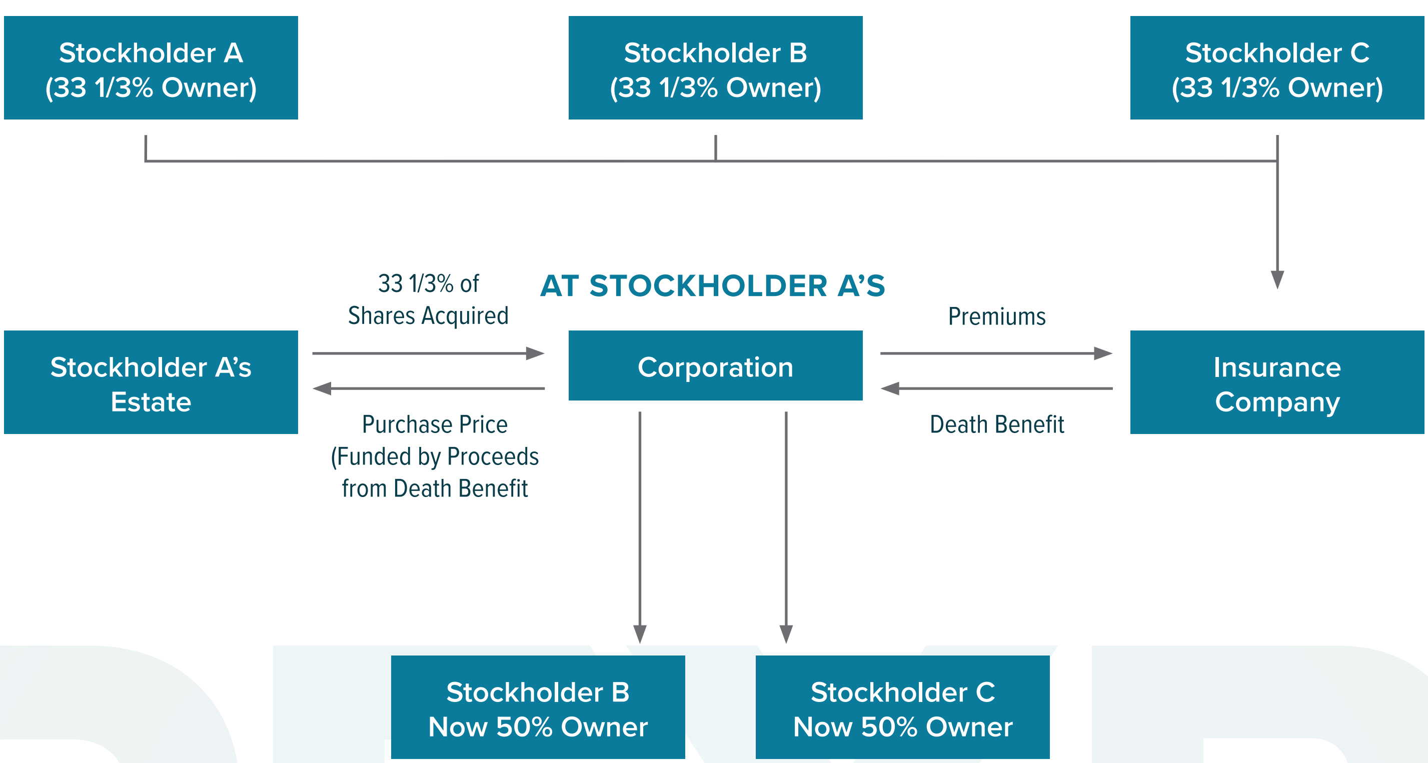
ENTITY PURCHASE BUY-SELL AGREEMENT

Under an entity purchase agreement, also known as a stock redemption agreement, when the entity is a corporation, the business itself will enter into an agreement with each owner to purchase a deceased owner's business interest. The agreement stipulates that the deceased owner's estate must sell the business interest and that the business entity must buy the deceased owner's business interest. The agreement also establishes the price to be paid either based on a fixed amount or a formula.

Under this type of arrangement, the business entity buys a life insurance policy on the life of each owner based on the value of that owner's ownership interest. In successful businesses, additional insurance would be purchased as the value of the business continued to increase in value.

When a permanent life insurance policy is used for the funding, there can be sufficient flexibility to assist in a living buyout at retirement or disability if that is an event specified in the buy-sell agreement. The policy's accumulated values can be used as a down payment for an installment sale.

CURRENT OWNERSHIP



ENTITY PURCHASE BUY-SELL AGREEMENT
Continued

Advantages

- Creates a market and establishes a fair price for the business interest.
- Provides the funds to make the purchase.
- Avoids a forced sale of assets.
- Can provide liquidity to the estate of the deceased owner.
- Creates a smooth transition for management and control so that the surviving owners avoid a conflict of interests with the deceased's heirs.
- Life insurance payable to the business entity provides the liquidity to buy out the deceased owner's interest.
- The deceased's estate is assured prompt and full payment.
- The number of policies that needs to initially be purchased is limited to one policy for each owner.
- Because the business is paying the insurance premiums, there is a pro-rata share of the costs between the owners according to their share in the business without concern as to age, smoker status, or health ratings.
- Life insurance cash values are shown as an asset on the business balance sheet.

Other Considerations

- Life insurance premiums paid by business are not deductible for income tax purposes.
- Death proceeds received by the business are generally received income tax-free. However, under Internal Revenue Code Section 101(j), for employer owned policies there must now be a specific written notice and consent by the insured prior to policy issue or certain exceptions must apply. Otherwise, the portion of the death benefit in excess of premiums paid will be taxable for income tax purposes. Pinnacle can provide a sample consent form.
- If the business entity is a C corporation, the surviving owner's cost basis in the business is not increased for tax purposes. For pass-through entities such as partnerships and S corporations, there is a step up in basis. This is important if one or more of the surviving owners wish to eventually sell their interest during their lifetime.
- An entity purchase agreement may be unwise for a closely held family owned C corporation. At an owner's death, the family attribution rules may cause the corporation's payment for the owners shares to be treated as a taxable dividend.
- If the entity is a C corporation, in some instances life insurance proceeds received can cause an alternative minimum tax liability. In reality, the AMT will not be applicable in many instances, or may be nominal in amount and recoverable in subsequent tax years.

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