Buy-Sell Planning Using Life Insurance



Entity Purchase Arrangements

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LIFE INSURANCE

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Entity Purchase Arrangements Using Life Insurance

You and your partners have a growing business with a bright future. That's why it is important to plan for unexpected events that could negatively impact its success. Have you thought about what would happen to the business if one of your co-owners were to die unexpectedly? Where would you get the money to fund the buyout of his or her share?

Entity Purchase Arrangements are one way you can help ensure the continued success of your business so that you can focus on what you do best — taking care of business.

In an entity purchase arrangement, also known as a stock redemption for corporations, the business itself will enter into an agreement with each owner to purchase a deceased owner's business interest. To accomplish this, the business purchases a life insurance policy on each owner's life in an amount that equals the value of his or her respective ownership interest in the business. The policy proceeds are used to buy back their interest from the deceased owner's estate.

Some Potential Advantages

- **Administrative ease:** The number of policies that need to be purchased is limited to one policy for each owner.
- **Equalization of payments:** Because the business is paying all insurance premiums, there is equalization of premium costs among owners. Factors such as age, smoker status, and health ratings may be less of an issue.
- **Business pays the premiums:** It may be psychologically easier for business owners to pay premiums from the business account than from a personal account.
- **The policy is a business asset:** The insurance policies are shown as an asset on the business' balance sheet.

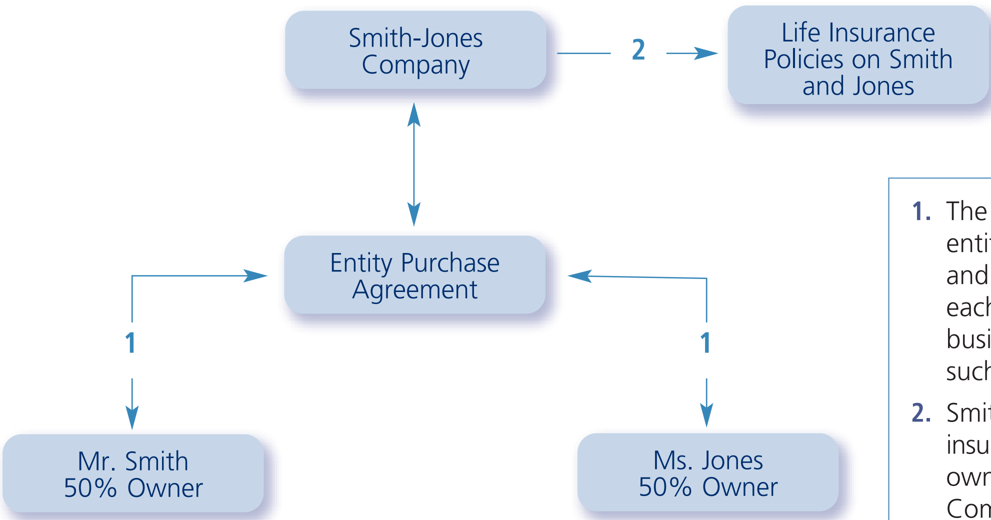
Some Potential Disadvantages

- **Policies and cash value are subject to creditors of the business:** Because the policies are owned by the business, they are considered assets that may be attached by the business's creditors.
- **No basis credit for entity redemption:** The surviving owners' basis in their interests will not change, even though the value will increase as a result of the redemption. This is important if any of the surviving owners sells stock before his or her death, since capital gains tax will be paid on all proceeds greater than the owner's basis.
- **Non-deductibility of premiums:** The life insurance premiums are non-deductible under IRC §264(a).
- **Increase in value of entity:** The life insurance proceeds may increase the value of the entity for estate tax purposes because the business owns the policy.

Note: For policies issued after August 17, 2006, IRC 101(j) provides that death benefits from an "employer-owned life insurance" policy are income taxable in excess of premiums paid, unless an exception applies and certain notice and consent requirements are met before the policy is issued. Please consult your tax or legal advisors for more information.

How it Works

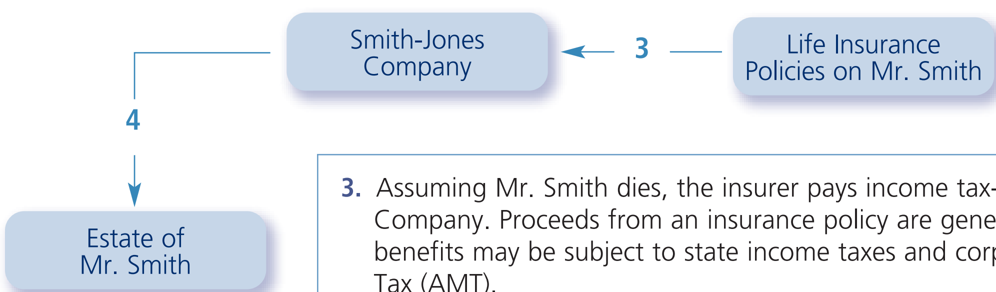
Establishing and Funding the Plan



1. The Smith-Jones Company establishes an entity purchase agreement with Mr. Smith and Ms. Jones. Mr. Smith and Ms. Jones each agree to sell their interest to the business at death or other triggering event such as disability or retirement.
2. Smith-Jones Company purchases a life insurance policy on each owner equal to the owner's share of the business. Smith-Jones Company is the beneficiary of the policy.

Smith-Jones Company is the owner, beneficiary and premium payer for the insurance.

At Death



3. Assuming Mr. Smith dies, the insurer pays income tax-free proceeds to Smith-Jones Company. Proceeds from an insurance policy are generally income tax free. The death benefits may be subject to state income taxes and corporate Alternative Minimum Tax (AMT).
4. Smith-Jones Company pays the proceeds to Mr. Smith's estate in exchange for the estate's interest in the business.

Result

Smith-Jones Company continues with the surviving owner in control of the business. The estate of the deceased has cash from the sale of the business interest.

Next Step

Designing a business continuation plan is a crucial step to ensure your business remains intact 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 an entity purchase arrangement, you can help protect yourself, your business, co-owners and your family.

Talk to your tax and legal advisors to determine if an entity purchase arrangement using life insurance may meet your specific needs.

For more information please call your ING Financial Professional.

117674 06/22/2010