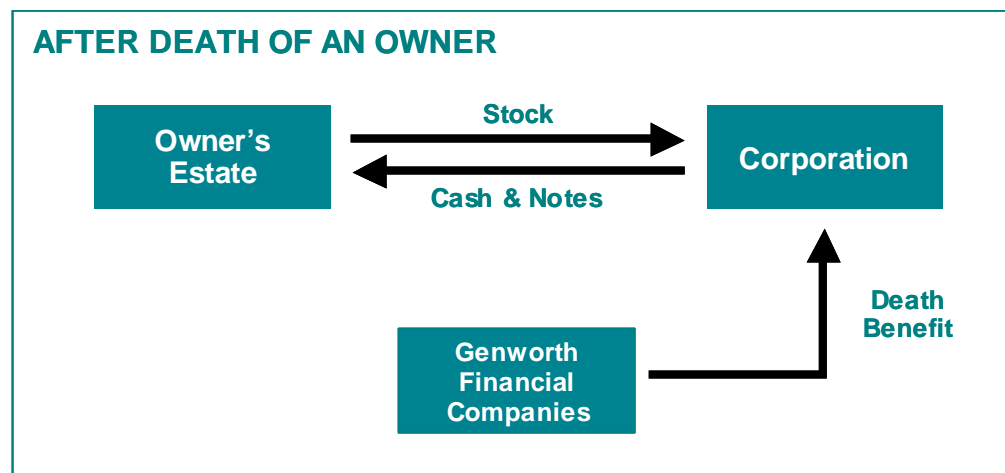
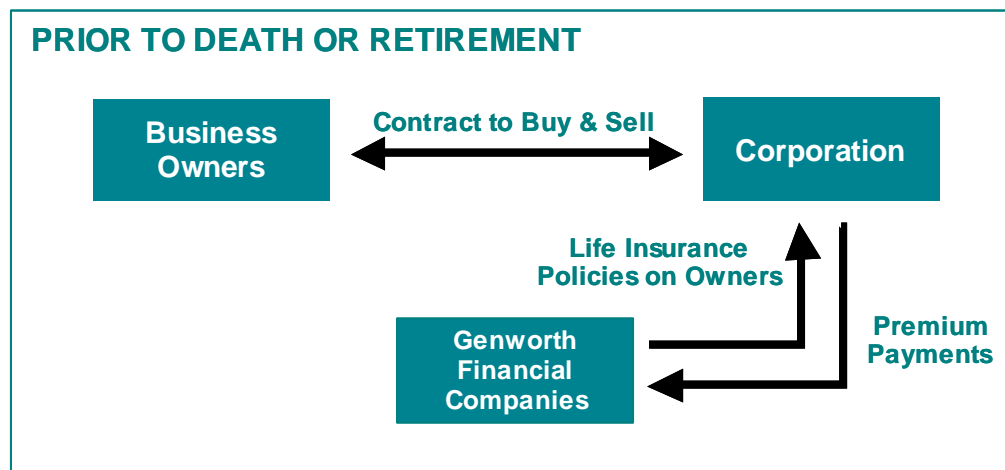


## Stock Redemption Buy-Sell Arrangement

A successful business like yours doesn't just happen. It is through your personal time, energy, and money that the business reaches this level of success and becomes a source of personal pride for the owners.

Through your efforts, the business becomes a source of income for you and your family, jobs for employees and contributions to the community. Without proper planning, it could all disappear.

A buy-sell agreement is a contract that identifies a buyer for your business interest in the event of your death, disability, or retirement and establishes a fair price for your heirs. When taking the form of a stock redemption, the agreement contractually obligates the corporation to buy the stock of the deceased or departing owner, and the departing owner (or the estate) becomes obligated to sell the stock to the business. When using life insurance, the corporation can be confident that some or all of the money needed to complete the purchase will be available at the death of an owner.<sup>1</sup>



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Standards Association  
(IMSA). Membership  
promotes ethical market  
conduct for individual  
life insurance and  
annuity companies.

## **FEATURES:**

- Identifies a ready buyer for the stock and creates a way to determine the purchase price for the stock.
- Provides surviving owners the assurance that they will be able to continue the operation of the corporation without interference from an unwelcome outside party or an inexperienced heir.
- Gives both creditors and employees some confidence that the corporation will continue beyond the death, disability, or retirement of one of the owners.
- The plan requires only one life insurance policy for each owner. The business is the owner and beneficiary of the policies.
- If cash value life insurance policies are used, the corporation may use any available cash value to help buy the stock when an owner retires or withdraws from the business.
- The cash value of the life insurance policy may be carried as an asset on the corporation's balance sheet without excess accumulated earnings concerns.
- The corporation may access policy cash values via policy loans, partial surrenders, or withdrawals, subject to policy limitations and restrictions in the buy-sell agreement.
- Creditors may be more willing to extend credit to a business with a funded business continuation plan in place.
- Life insurance policies owned by the corporation may be transferred to the respective insureds without creating a transfer-for-value problem.
- There is no direct premium burden on owners because the corporation pays the premiums.
- It may be psychologically easier for business owners to pay premiums from the business account than from a personal account.
- Each owner will hold the same relative interest after the buyout.

## **TAX CONSIDERATIONS:**

- Death benefits from an employer-owned life insurance policy are generally income tax free. In some situations, those death benefits may be partially or wholly taxable. These include a transfer of the policy for consideration unless an exception applies, arrangements that lack an insurance interest under state law, and an "employer-owned" policy issued after August 17, 2006 unless notice and consent requirements are complied with and the proceeds fall under a safe harbor (IRC §101(j)).
- The corporation may not deduct premiums for a life insurance policy used in the buy-sell arrangement.
- Any growth in the cash value in a life insurance policy is income tax deferred until removed from the policy.

- In a C corporation, life insurance cash value and death benefit proceeds may be subject to corporate AMT.<sup>2</sup>
- The corporation may access policy cash values on a tax favored basis if the policy is not a modified endowment contract.<sup>3</sup>
- Death benefits received by the corporation as beneficiary under the policy are not included in the insured owner's estate if the insured did not possess any incidents of ownership in the policy within three years of death. Majority ownership in the business may result in the insured possessing incidents of ownership in the policy.
- Death benefits payable to the corporation will not increase the value of the decedent's interest if a) the death proceeds are specifically excluded from the purchase price under the terms of the buy-sell agreement, and b) the agreement is successful in establishing the value of the business for estate tax purposes.
- The decedent's estate gets a step-up in basis to the value of the decedent's stock on the date of death or on the alternate valuation date. When the business redeems the decedent's stock, the purchase will be treated as a capital transaction, not a dividend.<sup>4</sup>
- If the estate sells the stock shortly after the owner dies at a price equal to the date of death value, there will be little or no gain for capital gains tax purposes.
- In a C corporation, surviving owners do not get a step-up in basis on their own stock.
- The payment of premiums by a corporation that is the beneficiary of a policy on the life of a shareholder will not be taxed to the shareholder as either a constructive dividend or as salary.
- But if the corporation pays premiums for a policy owned by one shareholder on the life of another, that payment is likely to be considered a distribution of dividends to the policyowner-shareholder.
- A life insurance policy owned by the corporation may not be transferred to shareholders other than the insured without creating a transfer-for-value problem.

## **DISCLAIMER**

The Genworth Financial companies wrote this content to help you understand the ideas discussed. Any examples are hypothetical and are used only to help you understand the ideas. They may not reflect your particular circumstances. You should carefully read your contract, policy, and prospectus(es), when applicable. What we say about legal or tax matters is our understanding of current law; but we are not offering legal or tax advice. Tax laws and IRS administrative positions may change. We did not write this material for use in avoiding any IRS penalty and neither you nor anyone else may use it for that purpose. You should ask your independent tax and legal advisors for advice based on your particular circumstances.

If this material states or implies that it was prepared or distributed to promote, market or recommend an investment plan or arrangement within the meaning of IRS guidance, or such use may be reasonably expected, then, as required by the IRS, the following also applies:

The tax information in this material was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in this material.

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<sup>1</sup> All guarantees are based on the claims-paying ability of the issuing insurance company.

<sup>2</sup> For larger corporations (i.e., those with average annual gross receipts in excess of \$7.5 million for the three previous tax years), the annual cash value increase and the death benefit in excess of the cash value are preference items that may increase the alternative minimum tax payable by the company.

<sup>3</sup> Policy loans, partial surrenders and withdrawals have the effect of reducing the death benefit and cash value. If amounts withdrawn or surrendered exceed the owner's basis in the policy or if a policy with an outstanding loan is surrendered, a taxable event may occur. A policy loan is generally not taxable unless the policy is surrendered with an outstanding loan balance. In certain highly funded cases, life insurance policies may be considered Modified Endowment Contracts (MECs). In such cases, distributions will be taxable income to the extent that there is gain in the contract. In addition, a 10% IRS penalty tax may be due on any taxable income received.

<sup>4</sup> If other family members own stock in the business, family attribution may apply. An individual is deemed to own stock legally owned, either directly or indirectly, by his/her spouse, children, grandchildren, and parents. Because of these attribution rules, the redemption of a departing owner's stock may be construed as a partial redemption, resulting in dividend treatment of the purchase price. A departing owner must have his/her entire interest in the business redeemed in order to receive the more favorable capital gains tax treatment. This tax result can be avoided if the redemption comes within the safe harbor of IRC §302. The safe harbor rules say that a corporate distribution as payment for its stock will be treated as a sale or exchange if:

1) it is not essentially equivalent to a dividend; 2) it is substantially disproportionate with respect to the stockholder's interest; 3) it effects a complete termination of the stockholder's interest; or 4) it is in partial liquidation of the redeeming corporation. If the redemption does not satisfy one of these safe harbor exemptions, the distribution will be taxed as a dividend.

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Genworth Financial companies include:

**Genworth Life and Annuity Insurance Company**, Richmond VA

**Genworth Life Insurance Company**, Lynchburg, VA

**Genworth Life Insurance Company of New York**, 666 Third Avenue 9<sup>th</sup> Floor, New York, NY 10017

Only Genworth Life Insurance Company of New York is licensed in New York.

Variable products issued by Genworth Life and Annuity Insurance Company and in New York by Genworth Life Insurance Company of New York.

Principal Underwriter: Capital Brokerage Corporation (dba Genworth Financial Brokerage Corporation in Indiana) 6620 West Broad Street, Building 2, Richmond VA 23230, Member FINRA/SIPC