SPECIAL PURPOSE BUY/SELL INSURANCE LLC

WHAT IS A SPECIAL PURPOSE BUY/SELL INSURANCE LLC?

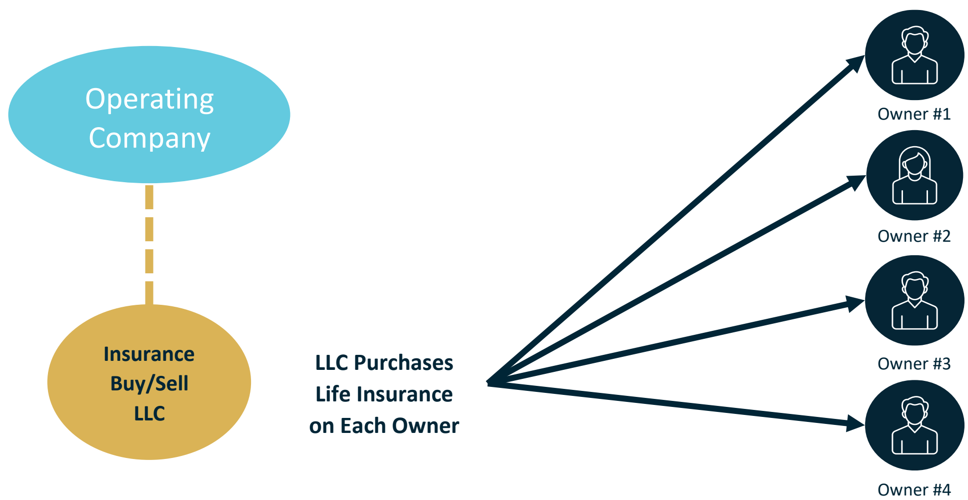
This structure utilizes a separate entity from the operating company to put in place a funded buy/sell arrangement. The LLC, taxed as a partnership, is used to own life insurance policies insuring the lives of multiple owners of a company and will also be the beneficiary of these policies. The tax-free death benefits[1] are allocated or distributed to surviving members of the LLC, which are in turn utilized to purchase the deceased's ownership in the operating company.

ADVANTAGES OF USING A BUY/SELL INSURANCE LLC:

- Simplified execution for multiple owners—one policy per owner
- Surviving owners receive an increase in basis in operating company
- More desirable funding solutions for policies with large premium differentials
- Improved creditor protection benefits[2]
- Improved estate planning opportunities

HOW DOES IT WORK?

<u>Owners establish an LLC to be the owner, beneficiary, and payor of life insurance.</u> Generally, the ownership in the newly formed LLC will mirror that of the operating company. Special allocations are carefully crafted to provide that owners of distinct life insurance policies are able to commit their share of premium to the LLC accurately.[3] There are three common ways for members to allocate premium; 1) Pro Rata, 2) non-insureds pay the premium, or 3) insureds pay their own premium. Generally, structured as a partnership, which can remove transfer-for value concerns at retirement.



<u>Death Benefits are paid to surviving members' capital accounts.</u> Upon the death of an owner, the proceeds will be paid into the surviving owners' capital accounts of the LLC. The proceeds are now available for the surviving owners to purchase the deceased's shares in the operating company. If structured as a cross-purchase arrangement, the surviving owners should receive an increase in basis in the operating company – something lacking in a Stock Redemption Buy/Sell.

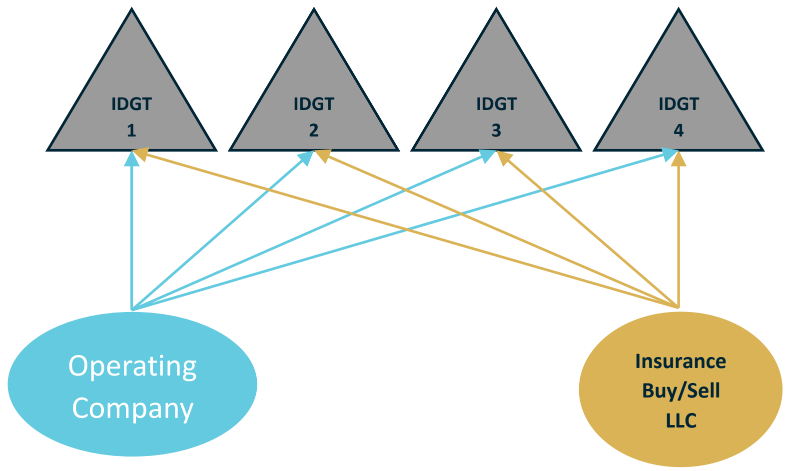
<u>Retirement Planning.</u> The use of permanent life insurance provides to the owner the option of accessing policy cash values on an income tax-free basis. This cash value can be used for supplemental retirement income or any other lifetime need. This could be accomplished with withdrawals from the policy and distributions from the LLC (subject to a members' basis in the LLC). Alternatively, the LLC could distribute the policy to the insured-member if the member retires from the operating company and is no longer a member of the LLC since his/her obligations under the buy/sell arrangement has ended.

Keep in mind though, basis in the contract may be adjusted under partnership rules and will likely be different from the insurance carrier's accounting.

INTEGRATING THE ESTATE PLAN

Member-Managed vs. Manager-Managed. LLCs can be managed by their members; this is known as being member-managed. An LLC may also be managed professionally, in which case it is known to be manager-managed. For clients who have estate tax concerns, an independent manager should manage the LLC. This aides in establishing that there were no incidents of ownership over the life insurance policies owned by the LLC. If incidents of ownership are found, the death benefit will be included in the insured's gross estate.[4] The LLC should prohibit the members from serving as managers and not allow them to exercise any right or power with regard to life insurance policies insuring their lives.

Potential for seamless integration into the estate plan. An owner could remove shares in the operating company from the taxable estate. The LLC can use proceeds to purchase shares of the operating entity not directly from the deceased's estate, but from the deceased's trust for the benefit of the deceased's heirs. An Intentionally Defective Grantor Trust (IDGT) may be particularly useful in this structure.



KEY CONSIDERATIONS

As with any employer-owned coverage, compliance with certain notice & consent requirements may be necessary.[5] The Tax Act of 2017 included an additional hurdle for considering Transfer-for-Value issues. Care should be taken not to trigger a Reportable Policy Sale.[6] There are many variables that can affect an individual owner and as such the advice of the client's attorney and CPA is essential to providing a sound recommendation.

1. Per IRC §101(a)
2. Creditor protection varies by state and may not be available in all situations.
3. A "special allocation" permits the partners to treat an item of income or deduction on a non pro-rata basis provide that the special allocation has substantial economic effect and certain other regulations are observed. See PLR 200747002.
4. Per IRC §2042 & IRC §2033
5. IRC §101(j)
6. IRC §101(a)(3)