CORPORATION CROSS-PURCHASE BUY-OUT WITH TRUSTEE (INCLUDING DISABILITY)

Insurance Policies and the Trustee

This agreement contemplates three or more stockholders, who are desirous of using the cross-purchase buy-out method. Where more than two stockholders are involved in a cross-funded arrangement, a multiplicity of policies results. For example, if three stockholders are involved, each is required to purchase a separate policy on each other stockholder equal to his purchase obligation. In this hypothetical situation, this means six separate policies, each having a separate policy fee, and with universal life plans, minimum premium requirements, separate "floors" to obtain current investment yields, separate cash withdrawal and surrender costs, and finally, where "banding" is involved, affect mortality costs and investment yields. To obtain the number of policies required where "N" equals the number of stockholders, apply the following formula: N (N - 1). E.G., where three stockholders are involved, 3 (3 - 1) = 6.

To resolve the multiple policy problem, a trustee arrangement is employed. Frequently, the corporation's attorney or CPA is designated the trustee or escrow agent in the buy-out agreement, or alternatively, a bank trust department can be appointed. The trustee purchases increasing death benefit life insurance and individual disability insurance upon each stockholder's life in an amount equal to his total stock interest. In this fashion, only one policy is required on each stockholder (just as in the redemption approach). The trusteed arrangement really bears more resemblance to an escrow arrangement to implement the buy-out terms. The trustee is the owner and beneficiary of each policy on the stockholders, and is directed to use the proceeds or benefits in funding the buy-out obligations. **Note:** the trustee must exist before title to the insurance policies is obtained. Therefore, the buy-out agreement must be drafted and executed before the policies are applied for.

The trustee will also hold custody of all stock certificates, which are endorsed to reflect that the shares are subject to the buy-out agreement. Of course, upon the death, disability or retirement of the stockholder, the trustee collects the proceeds or benefits, transfers them to the appropriate party, and upon completion of all sales terms, assigns the stock certificates to the surviving stockholders.

Disposition of Life and Disability Policies on the Surviving or Non-Disabled Stockholders

To maintain the valuable insurance protection on the surviving, non-disabled, or non-retiring stockholders, the trustee should be given specific instructions in the agreement. Normally, each stockholder desires to obtain the insurance owned by the deceased, disabled or retiring stockholder on his co-stockholders to complement his newly increased purchase obligations under the agreement. There are no tax obstacles in transferring disability policies for value to non-insured co-stockholders, though a severance of the policyowner's equitable interest may be required.

On the other hand, life insurance policy transfers to the non-insured stockholders run head-on into the "transfer for value" rule. IRC Sec. 101(a)(2). However, since A's equitable interest on the two policies on his co-stockholders passes to his estate at his death, the following course of action might be considered. First, the trustee requests the insurer to sever A's equitable interest on his co-stockholders into separate policies. The trustee can then transfer title to A's interest directly to his estate. In addition to simply surrendering the policies for cash, A's executor has two options:

1. Assign the policies for value to the respective insureds, as personal protection. Such a transfer is an exception to the rule.

2. To provide continuing buy-out funding protection, the executor can assign the severed policies to the corporation for value. This transfer is also an exception to the transfer for value rule. Thereafter, the buy-out agreement is amended to a hybrid, cross-purchase/stock redemption. (An optional buy-out is, of course, ready made for this contingency).

Of course, the same procedure is utilized for lifetime transactions, except the severed policies are transferred to A individually, who thereafter assigns them for value to the insured or the corporation, as the case may be. In this fashion, the lower-premium-priced insurance protection is preserved, and in some circumstances, where the insureds have become uninsurable or highly rated, this provision provides a true life saver.

Determining the Buy-Out Values

Corporate values are to be determined by adding to the "adjusted book value" and goodwill, if any. Thus, corporate assets will be adjusted to reflect assets carried below market value and assets that have been depreciated below current market value. The purchase price should be re-determined under the same procedure every one to two years. If the stockholder dies or retires beyond the valuation period, the corporation's CPA is directed to revalue the corporation, using the above procedure. (Arbitration is an alternative.) The disability purchase price is to be determined by the corporation's CPA, using the same valuation method as above, but at the *expiration of the disability waiting period elected*.

To add certainty to the arrangement, the buy and sell obligations are mandatory, not optional. The resulting equity ownership among the surviving or remaining stockholders is proportional (though the terms may be modified to any resulting equity ownership desired).

Lifetime Installment Sales Tax Treatment

This agreement contemplates that life insurance cash values will be used to fund the lifetime installment sale obligations. Generally, policy cash values can be tailored to fully fund an installment sale at retirement. On the other hand, the policy disability waiver of premium rider releases premium dollars upon disability, as well as creating future cash value increases. These disability cash sources are a big assist in the disability buy-out, particularly if complemented with individual disability income protection. Under either lifetime buy-out obligation, the policy owning trustee has the privilege of exercising policy loan or withdrawal rights to reach the cash values. An added benefit is that in most instances the remaining death benefits are sufficient to prepay any remaining installment balance, if the stockholder dies within the installment purchase period. A further advantage of this agreement is the stockholder's ability to spread his long-term capital gains under favorable installment sales treatment where he receives at least one payment after the close of his taxable year. IRC Sec. 453.

Advantages of the Cross-Purchase Method

Some of the advantages of the cross-purchase method are:

- Neither lifetime cash values nor death proceeds are subject to corporate creditors;
- The surviving stockholder(s) receives a full "step-up" in tax basis, equal to the full amount of life insurance proceeds;
- There are no concerns for dividend treatment of the purchase price to the deceased's estate, nor worry over possible accumulated earnings penalty.

Corporation Cross-Purchase Agreement - With Trustee

________________, ________________ and ________________ (hereinafter referred to as "stockholders," or individually as "stockholder"), each owning capital stock in ________________ Inc. (hereinafter referred to as "corporation"), and ________________ (later referred to as "trustee") agree for themselves, their heirs, successors, and personal representatives, as follows this day ____________ of ________________.

Article 1 - Purpose

The purpose of this agreement is to provide for the purchase by each stockholder of the other's corporate interest (as reflected in this agreement, or alternatively, in the Schedule of Value, attached hereto). Stockholders agree that such purchase and sale shall occur upon the death, disability, retirement, or withdrawal of any stockholder. Each stockholder agrees to endorse his stock certificates to reflect that they are subject to this agreement, and to transfer custody to the trustee hereunder. To facilitate such purchase and sale, trustee accepts appointment and agrees to perform the duties herein specified.

Article 2 - Agreement to Buy and Sell Upon the Death of the Stockholder

Upon the death of a stockholder, that stockholder's personal representative shall sell, and the surviving stockholders shall buy, all of the deceased stockholder's estate and the surviving stockholders shall provide such instruments as may be necessary to complete the sale and purchase hereunder. Any stock subsequently acquired by a stockholder shall likewise be subject to purchase and sale under the terms of this agreement.

Article 3 - Valuation and Purchase Price

The outstanding capital stock of corporation consists of _____________ shares which are held and owned by the stockholders as follows:

Name	Value	Percentage Interest
_____________________________:	$__________________;	(____________%)
_____________________________:	$__________________;	(____________%)
_____________________________:	$__________________;	(____________%)

In arriving at the stock values ascribed above, the corporation's certified public accountant has determined the current market value of all corporation assets, making such adjustments for tax-depreciated assets and undervalued or overvalued assets as is required to more clearly reflect current market values, and adding thereto a value ascribed and mutually agreed to by the parties for goodwill. Such value may be changed from time to time by the parties hereto by endorsement opposite their signatures in the "Schedule of Value" attached; provided, however, that if the parties neglect to revalue the corporation for a period in excess of (*one/two*, etc.) years, the corporation CPA is directed to apply the same valuation procedure, measuring adjusted asset values and goodwill as of the last day of the month preceding the death, retirement or withdrawal of a stockholder.

The retiring or withdrawing stockholder (or, in the event of death, the stockholder's personal representative) and the surviving or remaining stockholder may nevertheless mutually elect to accept the last valuation made as controlling for purchase and sales purposes. Disability purchase and sales value shall be determined as provided in Article 7.

This sample document was designed to be of assistance to attorneys who may be called upon to draft business arrangements involving disability buy-out insurance. It is not intended for direct use by an insurance representative. Clients need to be aware that the advice of their own tax attorneys and/or accountants is vital. This sample document is provided solely for informational referential purposes and does not constitute tax, legal or financial advice.

Article 4 - Insurance

To provide cash to purchase the stock of a deceased stockholder, trustee shall apply, as owner and beneficiary, for an increasing benefit life insurance policy upon the life of each stockholder, in an amount equal to the purchase of price-valuation established under Article 3. Such policies purchased to date or any policies hereafter acquired shall be listed on the attached "Schedule of Life Insurance."

Based upon current corporate values, trustee will hold title to policies on each stockholder's life, and correspondingly, each stockholder obtains equitable title to the insurance on each other stockholder's life in the following amounts:

Insured	Policy Amount	Stockholder's Equitable Interest	
		Name	Interest
______________	$______________	______________	
		______________	
______________	$______________	______________	
		______________	
______________	$______________	______________	
		______________	

With 30 days of a policy anniversary, each stockholder shall transfer to the trustee sufficient cash for premiums necessary to maintain his equitable interest on each policy or policies on his co-stockholders, as provided above, and shall provide the insured stockholder evidence of such transfers. Where the "split dollar" technique is employed, the trustee is authorized to receive from the corporation its premium share under the arrangement. Trustee shall immediately thereafter remit such cash premium contribution(s) to the insurer. In the event a stockholder fails to transfer such cash premiums within such period, the insured stockholder may pay the premium to the insurer, and such premium advances shall be added to the purchase price of his stock interest. While this agreement remains in force, the trustee shall provide written notice to the stockholders of his intent to exercise any of the policy rights, options or privileges.

Article 5 - Terms of Payment Upon Death

Upon the death of a stockholder, the surviving stockholder shall promptly make claim for the death proceeds of any life insurance policies insuring the life of a deceased stockholder. If the insurance proceeds are equal to or in excess of the then current purchase price, the surviving stockholder shall pay over the full purchase price to the deceased stockholder's estate in cash. The excess proceeds, if any, shall be retained by the surviving stockholder, free of any obligations under this agreement.

If the insurance proceeds are less than the then current purchase price, said proceeds, and an additional amount equal to the difference between said proceeds and the purchase price, shall be paid over to the deceased stockholder's estate. Provided, however, that the surviving stockholder shall have the option to pay such balance in cash, or by promissory notes, with provision for annual payments on the principal over a period not to exceed ______ years from the date of the decedent's death, with interest at the rate of ______% per annum. Said notes shall provide for optional acceleration of maturity in the event of a default in payment of principal or interest, and, at the option of the deceased's estate, shall be additionally secure by a pledge of all or a portion of the deceased's stock. The surviving stockholder shall have the unrestricted option to prepay, without penalty, any promissory note issued under these circumstances, in whole or in part.

The deceased stockholder's personal representative shall thereupon deliver to the surviving stockholder any assignments, bill of sale, or other necessary legal evidence of title as required to transfer all the deceased stockholder's right, title and interest to the stock of corporation. Further, deceased stockholder's personal representative shall have the right to rescind this agreement in the event the surviving stockholder fails to perform under the purchase terms above, or to execute such promissory notes and provide requested security for any portion of the purchase price not received in cash.

Article 6 - Lifetime or Retirement Sale; Restrictions or Encumbrance

In the event a stockholder desires to sell his corporate interest during his lifetime or upon retirement, he shall be precluded from selling or offering to sell his stock to any other person or institution until he has offered to sell to the remaining stockholder at the price determined under this agreement. The remaining stockholder shall have ______ days within which to accept this offer to sell, and if not exercised within such period the withdrawing or retiring stockholder may sell to such other person or institution as he so desires; provided, however, that he shall not sell such interest without first offering it to the remaining stockholder at the price and terms offered to such other parties.

In the event the remaining stockholder elects to purchase the retiring or withdrawing stockholder's interest, such purchase shall be made on an installment sale basis. The remaining stockholder shall make an initial down payment in cash of ___________

(______) percent of the purchase price as determined under Article 3. The remaining balance shall be paid in ________ (_____) equal annual installments, commencing with the annual anniversary of the initial down payment described in the preceding sentence.

The installment amounts due under the unpaid balance shall be evidenced by promissory notes with provision for annual payments on principal, as described in the foregoing paragraph, for _________ (______) year term, and with interest at the rate of __________ percent per annum. The note(s) shall provide for optional acceleration of maturity in the event of a default in payment of principal or interest, and at the option of the retiring or withdrawing stockholder, such notes may be additionally secured by a pledge of all or a portion of his corporation stock.

Article 7 - Disability Buy Sell

In the event a stockholder becomes "totally and permanently disabled" before attaining the age of sixty (60)*, and remains so for a period of ___________ (_____) months from the onset of such disability, the disabled stockholder (or his attorney in act) shall sell, and the non-disabled stockholder shall buy, the disabled stockholder's interest under the terms hereinafter set forth. The terms, "total and permanent disability," for purposes of this agreement, shall be considered that disability of the insured stockholder, as the term is defined under the disability waiver of premium rider included in the insurance policy(s) insuring the life of that stockholder. In the event the non-disabled stockholder has also obtained additional individual disability protection on such stockholder, then the definitional provision thereunder shall control with respect thereto.

*(The selected age here should coincide with the expiration date of the disability waiver of premium protection in the life insurance policy. On the other hand, if individual disability income policies are purchased to fully fund the disability buy-out, the selected age should coincide with expiration date of protection in those policies.)

[**Alternate Language for Individual Disability Policy Funding:** Replace the disability definition in the preceding paragraph, as follows:

"The term, 'total and permanent disability,' for purposes of this agreement, shall be considered that disability of an insured stockholder which is described and defined in the separate individual disability policies listed in the "Schedule of Disability Insurance Policies" attached hereto. No insurer shall be subject to any liability other than its contractual limits and liability under such policies."]

The purchase shall be determined by the corporation's CPA at the expiration of the disability waiting period elected in the preceding paragraph, and after applying the valuation method described at Article 3.

Disability Buy-Out Specimen Documents

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Such disability purchase shall be made on an installment sale basis. The non-disabled stockholder shall make an initial down payment in cash of ______________ (______) percent of the purchase price as finally determined. The remaining balance shall be paid in ______________ (_____) equal annual installments, commencing with the annual anniversary of the initial down payment, described in the preceding paragraph.

The installment amounts due under the unpaid balance shall be evidenced by promissory notes with provision for annual payments on principal for a ___________ (_____) year term, and with interest at the rate of _________ percent per annum. The note(s) shall provide for optional acceleration of maturity in the event of a default in payment of principal or interest, and at the option of the disabled stockholder, such notes may be additionally secured by a pledge of all or a portion of his corporation stock.

The disabled stockholder, his guardian or attorney in fact, shall, upon receipt of the initial down payment, the promissory notes, and additional security as desired, deliver to the non-disabled stockholder any assignments, bill of sale, or other necessary legal evidence of title as required to transfer all right, title and interest to his corporate stock.

If the disabled stockholder dies during the installment pay-out period, the non-disabled stockholder may, at his sole discretion, apply the net life insurance proceeds to prepay all remaining and unpaid installments, in a single lump sum to the deceased stockholder's estate.

Article 8 - Disposition of Life or Disability Policies On Termination of Agreement

In the event this agreement is terminated under any of the provisions of Article 14, the insured stockholder shall have the option, exercisable within thirty (30) days of such event to purchase from his co-stockholder the life insurance policy insuring his life for a price equal to the policy's interpolated terminal reserve value (plus any unearned premium and dividends, or cash accumulations, if any, and less any policy indebtedness or cash withdrawals) by giving written notice with such period to his co-stockholder. In a similar fashion, and upon the same conditions as above, each stockholder may purchase any disability policies insuring his life from the other for a price equal to the unearned premiums thereunder.

Conversely, if an insured stockholder fails to exercise these policy purchase options within the prescribed thirty-day period, the policy owning stockholder may retain or surrender the policies for cash.

Article 9 - Trustee Duties

a. *Stock Certificates*

Trustee shall receive and hold the stock certificates of all stockholders who are party to this agreement. Upon the death, disability or retirement sale of a stockholder's interest, and upon full payment of the purchase price under the terms of this agreement, the trustee will submit the purchased stockholder's share certificates to the corporation for reissue to the remaining stockholders according to their newly acquired legal interest. Upon the happening of any event specified in Article 14, trustee shall distribute to each stockholder, or his personal representative, his respective stock certificates.

b. *Life and Disability Insurance*

Trustee shall perform all acts necessary to obtain the life insurance described in Article 6, as well as any disability policies purchased under the provisions of Article 7. Trustee shall hold and maintain such policies in force. In meeting premium requirements, the trustee shall, within 30 days of a policy anniversary, provide notice to each stockholder of his share of premium contributions on his co-stockholders. In the event the "split dollar" technique is employed in the purchase of life insurance, such notice shall be provided to both the stockholders and the corporation, reflecting the respective premium contributions of each party.

Upon the death of a stockholder, the trustee shall make claim for and collect the proceeds of insurance upon the life of the deceased stockholder, and distribute such proceeds to the deceased stockholder's estate, as directed by the surviving stockholders, under the purchase terms of Article 5.

In a similar fashion, upon the disability of a stockholder, as defined in Article 2, the trustee may, at the direction of the non-disabled stockholders, apply the benefits of any individual disability insurance secured on the disabled stockholder, and further apply any life insurance policy cash withdrawals or policy loans, utilizing such benefits together with any other funds made available to it, to the disability installment purchase of the disabled stockholder's interest.

Upon a lifetime or retirement sale of a stockholder's interest, the trustee shall, at the direction of the remaining stockholders, apply life insurance policy cash withdrawals or policy loans, together with any other funds made available by the remaining stockholders, to the lifetime installment purchase obligation described in Article 6.

c. *Termination of Agreement*

Upon the termination of this agreement under any of the terms set forth under Article 14, the trustees shall immediately determine the "interpolated terminal reserve value" (as defined at Article 8), of each policy insuring the life of a stockholder hereunder. Similarly, trustee shall determine the unearned premium value of each disability policy insuring the stockholders herein. The trustee shall thereafter provide notice to each respective insured stockholder of such values, and for a 30-day period offer to transfer such policy to the insured in consideration of payment in cash of such value. Proceeds from such sale shall be distributed to the policy owning stockholders, as their equitable interests dictate.

If the insured stockholder elects not to purchase the policy or policies insuring his life within such 30-day period, the trustee shall surrender the policy or policies to the insurer thereof, and thereafter distribute to each stockholder cash representing his equitable interest therein.

d. *Removal or Resignation of Trustee*

Upon 30 days notice to the stockholders, the trustee may resign as trustee. Conversely, stockholders may remove or replace trustee and appoint a new trustee upon giving 30 days notice to the present trustee. If the trustee is removed or resigns his term, trustee shall deliver over to the stockholders all stock certificates and insurance policies held under the terms of this agreement, together with any other documents he may hold. Any successor trustee thereafter named by the stockholders shall have all the duties and powers herein conferred to the original trustee.

e. *Trustee Compensation*

Trustee's compensation for the performance of the administrative tasks required hereunder shall be as mutually agreed upon by the trustee and the stockholders.

f. *Trustee Liability*

Trustee shall not be liable for any damages sustained by the stockholders for any acts or omissions under this agreement, other than those caused by his own willful misconduct.

Article 10 - Insurer's Duties

An insurer's duties, liabilities and rights under any policy subject to this agreement shall be governed solely by the policy itself, without any regard whatsoever to the terms and provisions of this agreement.

Article 11 - Remedies for Failure to Perform

If either party to this agreement defaults or fails to complete his obligations under this contract, then such offended party may, at his option, seek damages for such default or breach, or obtain specific performance of the agreement, from a court of competent jurisdiction.

If any action is brought to enforce this contract, or any provision thereof, the prevailing party, whether plaintiff or defendant, shall be entitled to an allowance for reasonable attorney fees, plus cost of suit.

Article 12 - Notice

All notices, including offers or acceptances, shall be deemed received, if provided in writing and delivered in person to the other party, or mailed by certified or registered mail to the last known address of that party.

Article 13 - Amendment or Alteration

This agreement may be altered or amended in whole or in part at any time by filing with this agreement a written instrument setting forth such changes, signed by the parties to this agreement, and witnessed by disinterested parties.

Article 14 - Termination

This agreement shall terminate upon the occurrence of any of the following events:

a. Cessation of the business;

b. Bankruptcy or receivership of any stockholder;

c. Mutual agreement of the stockholders;

d. Failure of the stockholder to provide for any remaining purchase balance at a stockholder's death as required under Article 6.

Article 15 - Governing Law: Effect of Headings

a. This agreement shall be governed by the laws of the State of ____________________;

b. All Article headings set forth in this agreement are intended for convenience only, and shall not control or affect the meaning, construction or intent of this agreement, or of any provision thereof.

IN WITNESS WHEREOF, the stockholders have read and signed this agreement this _______ day of ________________________, ___________, at ______________________.

WITNESSES:

______________________________________ ______________________________________
Stockholder

______________________________________ ______________________________________
Stockholder

____
Trustee

<u>Consent of Spouses</u>

If a stockholder's spouse is a co-owner (i.e., joint tenant, or holds a community property interest), she should join in the agreement as follows:

I, the undersigned spouse of stockholder ________________________________, of _____________________________, hereby certify that I have read the foregoing Buy-Out Agreement; that I understand the terms thereof; that I have been advised of my property rights therein; and that I agree to be bound by this agreement and to sell any interest I have under the provision thereof.

WITNESSES:

______________________________________ ______________________________________
Spouse of Stockholder

Schedule of Value

The revised value of the corporation, as provided in Article 3, is as follows:

Effective Date	Agreed Value	Parties' Signatures
____________	____________	____________ Stockholder
		____________ Stockholder
		____________ Stockholder

Schedule of Life Insurance Policies

Insurance Company	Policy Date	Policy No.	Face Amount
____________	____________	____________	$____________
____________	____________	____________	$____________
____________	____________	____________	$____________

Schedule of Disability Insurance Policies

Insurance Company	Policy Date	Policy No.	Monthly Benefit
____________	____________	____________	$____________
____________	____________	____________	$____________
____________	____________	____________	$____________