

When a business partner leaves or retires, existing key-person and ownership-based life insurance policies often become outdated and potentially risky. Realigning coverage with the new ownership structure helps ensure the buyout is properly protected, long-term goals for both parties are preserved, the business remains stable, and unnecessary tax complications are avoided. Properly structured life insurance becomes a critical foundation for a smooth, tax-efficient business transition.

## CLIENT PROFILE

- Two business partners, *Owner A* (selling) and *Owner B* (remaining).
- Business is valued at **\$4.2M**.
- The partners currently hold:
  - Two **Key-Person** life insurance policies (each insuring the other).
  - An outdated **cross-purchase agreement** drafted 12 years ago.
  - Outdated **beneficiary designations** tied to the old structure.
- Owner A is retiring and selling their ownership stake to Owner B over a 3-year structured buyout.



## THE PROBLEM

### Current Policies No Longer Match Reality

After the sale, Owner B will become the sole owner—but the insurance structure still assumes a two-partner business.

This creates major issues:

### Misaligned Policy Ownership

- Owner A continues to own (or is insured by) policies that are no longer relevant.
- Owner B may be paying for premiums that no longer protect the business.

### Tax Consequences

- If the wrong entity owns the policy post-sale, death benefits may create **unexpected taxable events** or **transfer-for-value** issues.

### Unnecessary Ongoing Premiums

- Policies originally designed to protect against the loss of a partner are no longer needed.
- Cash value policies may contain unused equity that needs to be addressed.

### Estate and Buyout Risks

- Owner A's surviving family may lose the buyout income if the arrangement isn't insured properly.
- Owner B may not have liquidity if Owner A passes away during the payout period.

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## THE TRANSITION PLAN

**1. Evaluate Existing Key-Person Policies**

- Who owns the policies?
- Who pays the premiums?
- Who is the beneficiary?
- Are they still needed based on the new business structure?

**2. Repurpose or Replace the Insurance****Option A: Repurpose Into Buyout Protection**

- Convert existing policies so that Owner B becomes the policy owner.

- Update beneficiaries to protect:
  - The business
  - The buyout obligation

This ensures the buyout is completed even if Owner A passes away mid-transition.

**Option B: Terminate or Exchange**

- If policies are not needed:

- Consider a **1035 exchange** into a new policy (if cash value exists).
- Surrender term policies with no conversion value.

**3. Update the Buy-Sell Agreement**

- Shift from a **cross-purchase** to an **entity-purchase** structure (or vice-versa), depending on tax efficiency.

- Ensure insurance aligns with:
  - Final business value
  - Payment schedule
  - Responsibilities of each party

**4. Protect Owner A's Retirement Income**

- Implement a **life insurance-funded buyout guarantee**, ensuring Owner A's spouse or heirs receive remaining payments if Owner A dies early.

**5. Protect Owner B's Business**

- If Owner B dies unexpectedly during the buyout:
  - Business or estate liquidity may be insufficient.

- A new **Key-Person** or **Owner B personal coverage** can protect operations and ensure the buyout can continue.

## CRITICAL ITEMS DURING THE TRANSITION

<ul style="list-style-type: none"> <li>✓ Policy owner structure</li> <li>✓ Premium payer and beneficiary alignment</li> <li>✓ Business valuation updates</li> <li>✓ Buy-sell agreement accuracy</li> <li>✓ Transfer-for-value risks</li> </ul>	<ul style="list-style-type: none"> <li>✓ Policy conversion options (term to permanent)</li> <li>✓ Cash value availability and tax implications</li> <li>✓ Insurability changes for each owner</li> <li>✓ Coverage needs for Owner A's retirement obligations</li> <li>✓ Continuity risks for Owner B's business</li> </ul>
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