REALIGNING AFTER PARTNER BUYOUT

BUSINESS PLANNING

When a business partner leaves or retires, existing key-person and ownership-based life insurance policies often become outdated and potentially risky.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  - An outdated cross-purchase agreement drafted 12 years ago.
  - Outdated beneficiary designations tied to the old structure.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 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.

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

✓ Policy owner structure	✓ Policy conversion options (term to permanent)
✓ Premium payer and beneficiary alignment	✓ Cash value availability and tax implications
✓ Business valuation updates	✓ Insurability changes for each owner
✓ Buy-sell agreement accuracy	✓ Coverage needs for Owner A's retirement obligations
✓ Transfer-for-value risks	✓ Continuity risks for Owner B's business