Cross purchase buy/sell arrangement

The concept

A cross purchase buy/sell arrangement is an agreement in which the owners of a business draw up a contract among themselves promising that if one of them dies, retires or becomes disabled, the remaining business owners will purchase the departing business owner's interest. To fund their purchase obligations, the business owners often purchase and own insurance policies on each other's lives.

Benefits

This arrangement provides the business owners with a ready market for their interests at a fair price. Funding a cross purchase buy/sell arrangement with life insurance means that upon death, cash is available to immediately purchase the deceased business owner's interest. Additionally, if the purchase takes place while the business owner is alive, the policy's cash value may be used as a down payment, with the balance of the purchase price covered by installment notes.

Tax considerations

The purchasers of the departing business owner's interest will receive a step-up in basis for their acquired interest.

Steps

- The business owners enter into a written buy/sell agreement providing for the purchase and sale of a departing owner's interest upon their death, disability or retirement
- The owners purchase life insurance on each other's lives
- Upon an owner's death, disability or retirement, a sale of the departing owner's interest to the other owners takes place

How it works while employed

During life

Upon death of owner/insured A