LIFE INSURANCE

BUY-SELL PLANNING

Succession planning for business owners

FOR USE WITH THE GENERAL PUBLIC

Ohio National Financial Services®

Well-designed and effective buy-sell agreements always have two components – the legal document defining the agreement and the funding sources for the transaction.

Plan for your business continuation

Buy-sell planning can help you prepare for the continuation of your business and help ensure your family's financial security. This can typically be best accomplished by using a buy-sell agreement, a legal contract providing for the sale of a business ownership interest upon the occurrence of a triggering event, such as the owner's death, disability, or retirement.

A fully funded buy-sell agreement can:

- Predetermine the price, or method for determining the price, at which the buyer agrees to purchase, and the owner agrees to sell, his or her interest in the business;
- Create a market for each owner's share of the business;
- Provide plan funds when needed; and
- Establish the value of the business for federal estate tax purposes.

How it works

Business owners adopt a plan that will accomplish an orderly transfer of the business following a triggering event, the most common being the death, disability or retirement of an owner.

1. Life insurance or disability income insurance policies are purchased from Ohio National on the lives of the business owners. Upon the death or disability of an owner, the benefits provide the cash needed for the purchase of the business interest.
2. Upon disability or death of a business owner, proceeds from the disability or life insurance policy pass to the business (entity purchase) or to the surviving or non-disabled business owner (cross-purchase). When properly structured, benefits can be income tax free.
3. Pursuant to their written buy-sell agreement, the business (entity purchase) or the surviving or non-disabled business owner (cross-purchase) uses these proceeds to purchase the business interest from a disabled owner or the estate/heirs of a deceased owner.
4. The remaining owner(s) end(s) up with the entire business.
5. The deceased owner's family receives a pre-determined price, in cash, in exchange for the business interest.

Example: Cross-purchase buy-sell

Comparing buy-sell agreements

There are two main types of buy-sell agreements: (1) cross-purchase and (2) entity purchase. The type that is right for you and your business depends on a variety of factors including:

- Number of business owners;
- Relative tax brackets of the business and its owners;
- Desire for the owners to maintain control over the plan; and
- Other tax reasons, such as stepped-up basis.

Comparison of agreement types

	Entity Purchase	Cross-Purchase
Purchaser	The business	Business owner(s)
The plan	Business contracts with business owners that, upon the death or disability of any of them, the stock will be purchased by the business at an agreed-to price	Business owners agree among themselves to purchase stock of deceased or disabled business owner at an agreed-to price
Insurance funding	Business is applicant, owner, premium payor and beneficiary of a policy on each business owner, in an amount needed to assure performance of its obligation	Each business owner is applicant, owner, premium payor and beneficiary of policy(ies) on each of the other business owners
Number of policies needed	Only one policy per business owner is required	Each business owner must purchase a policy on each co-business owner(s) resulting in multiple policies for each insured when there are more than two business owners
Premiums on insurance	Nondeductible expense to the business	Nondeductible expense to the business owners
Income taxation to seller at death	None, due to stepped-up basis at death	None, due to stepped-up basis at death
Basis of remaining business owner(s)	Surviving business owners do not receive a full stepped-up basis since business is purchaser	Surviving business owner(s) receive(s) stepped-up basis to the extent of their purchase price for shares purchased from decedent's estate
Income taxation of sales proceeds to disabled business owner	Sales proceeds above basis are generally taxable to the disabled business owner. No step-up in basis is available because the sale occurs during lifetime.	Sales proceeds above basis are generally taxable to the disabled business owner. No step-up in basis is available because the sale occurs during lifetime.

Determining the value of your business

As a business owner, you may have a good idea about the selling price of your company. You have no doubt heard the expression "fair market value." Fair market value is the price a willing buyer would pay to a willing seller, with neither one being under any obligation to buy or sell.

Estimating the fair market value of your business is the first step to securing its future through buy-sell planning. The value of most businesses will be based on some or all of the factors listed below:

- The book value of the company;
- A multiple of each principal's salary or net distributive income;
- The earning capacity of the company;
- Recent sales of company stock;
- Dividend-paying capacity (both present and future);
- How the business performs compared to similar companies;
- Goodwill and other intangible assets;
- The nature and history of the business as it relates to risk and stability; and,
- Economic outlook in general, and that of the industry.

When valuing a business, some factors carry more weight than others, but there is no exact method to apply to all businesses. One thing is certain – many business owners are surprised at the value of their businesses when all the relevant factors are analyzed.

If you, like many business owners, need help in determining the value of your business, your accountant or an appraisal specialist can assist you.

Did you know ...

75%
of small businesses in the U.S. have not been professionally valued.

64%
of small businesses in the U.S. do not have a proper business continuation plan.

Source: Sizing up Small Business Owners, LIMRA 2015

Advantages of buy-sell planning

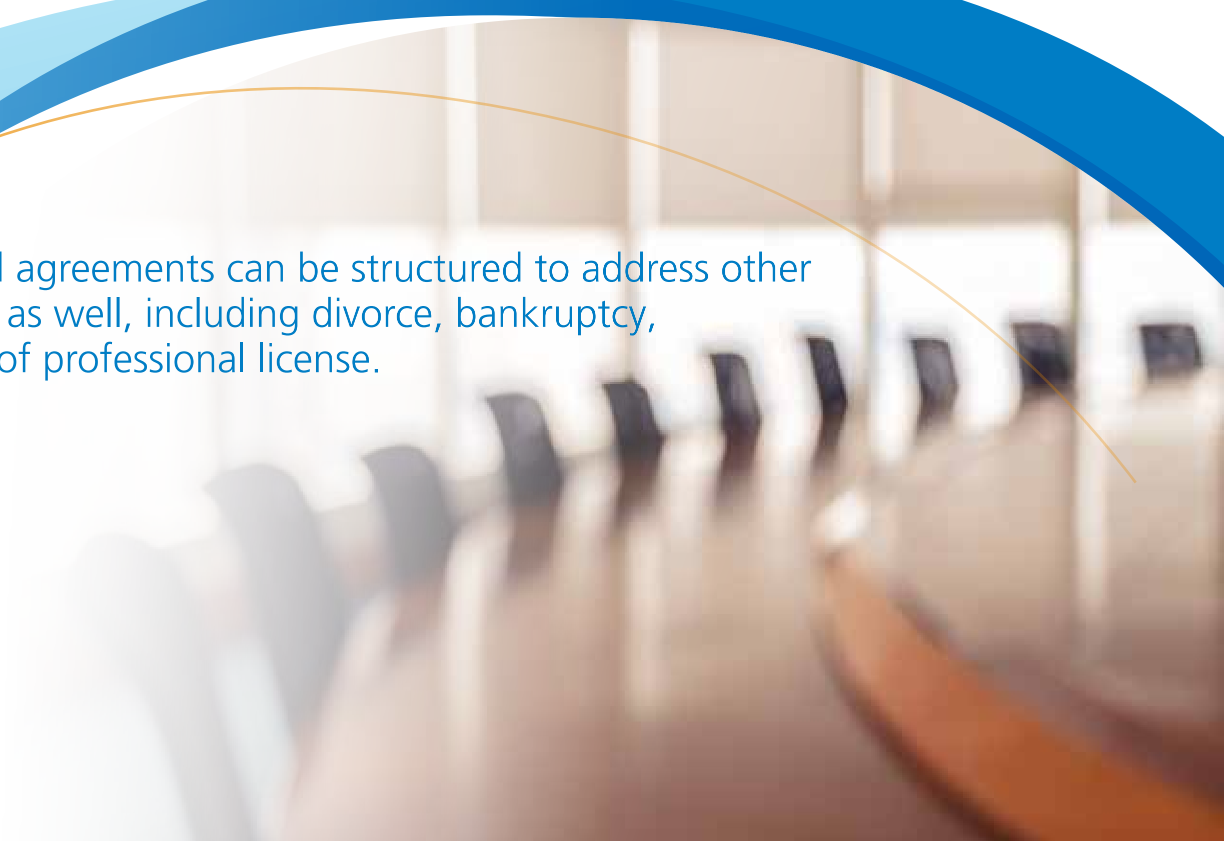
During life of owners:

- **For all business owners:** A funded buy-sell agreement helps give business owners the peace of mind that comes from planning for their and their families' financial security.
- **For creditors, suppliers and customers:** A funded buy-sell agreement helps to assure such people that the death or disability of a business owner will not disrupt the day-to-day operations of the business.
- **For employees of the business:** Buy-sell planning provides employees with a sense of security that comes from business continuity.

After an owner's death or disability:

- **For all remaining business owners:** A fully funded buy-sell agreement gives remaining owners, or the business, the opportunity and the cash to purchase the affected owner's business interest at a fair price.
- **For the affected owner or their heirs:** A fully funded buy-sell agreement can help ensure that the affected owner or their heirs will receive a pre-determined price for their business interest.
- **For the deceased owner's estate or the disabled business owner:** A funded buy-sell agreement can convert the business interest – a non-liquid asset – into the cash needed to pay expenses and debts incurred at the death or disability of the business owner.

Buy-sell agreements can be structured to address other events, as well, including divorce, bankruptcy, or loss of professional license.



Funding a buy-sell agreement

There are various ways to finance your buy-sell agreement:

Insurance

Funding your plan with insurance is generally the most certain and economical method for providing a definite amount of money at an indefinite time in the future. For example, life insurance pays a cash benefit precisely when the need arises: upon death of a business owner.

Cash

Most successful business owners, however, do not keep large sums of cash on hand. Instead, the money is tied up in their businesses.

Sinking fund

A sinking fund, in which a business sets aside earnings each year toward the buyout amount, is inadequate if death or disability is premature. Also, it is impossible to predict when death or disability may occur. Therefore, it is impossible to predict if, and when, a sinking fund will be sufficiently funded.

Bank loan

Loss of a business owner may impair the credit rating of the business. Also, interest adds to the cost of the buyout.

Installment payments to heirs

The business may fail and the payments stop. The principal and interest payments may be too burdensome for the business to handle, particularly after the loss of an owner.

Frequently asked questions

Q: How do I determine what type of buy-sell agreement is best for my business?

A: Several factors will influence the best type of buy-sell agreement for you, including the number of business owners involved. Because of the number of insurance policies required to fund the agreement, a cross-purchase plan would be cumbersome when there are three or more business owners.

Another determining factor is the relative tax brackets of your business and the owners. If there is a significant difference in tax brackets, it may be more cost-effective for one or the other parties to pay the premiums and own the policies.

Also, your accountant and/or attorney may have a strong reason for favoring one type of a buy-sell agreement over another. It also may make a difference to you or your partners as to whether you prefer to own the policies or want the company to own the insurance.

Q: Why do I need to make a formal agreement now when there are so many uncertainties? Why not wait until one of the owners actually dies or becomes disabled and make plans then?

A: The appeal of a buy-sell agreement is that it sets out the procedure for the orderly transfer of the business. While all business owners are alive and well, they are in an equal bargaining position, since no one knows who will be the first to die or become disabled. Once one owner dies or becomes disabled, the remaining owners have a bargaining advantage and perhaps an unwillingness to deal generously or fairly with the disabled business owner or family of the deceased owner.

Also, at their time of grief, family members (or, at the time of a disability, the disabled business owner) may not be prepared to deal with business negotiations, even though their financial needs may be great at this time. The need for cash might force them to sell the business at a less than fair price. Or perhaps, feeling that they are not getting a fair deal, they will sell their stock to an outsider, force a liquidation of the business or even sue the remaining business owners.

These events would disrupt the ongoing operation of the business. Therefore, business owners would be wise to set out a fair value ahead of time and fund the arrangement over time by adopting a well-planned buy-sell agreement.

Q: How much insurance is needed to fund the buy-sell agreement?

A: The proper amount of funding for a buy-sell agreement is related directly to the value of the business. Over the life of the company, its value is likely to increase as the business improves and grows. As a result, the amount of funding for the agreement will have to increase to keep pace.

There are several business valuation techniques and formulas available, but often the best valuation of the business is the price a willing buyer would offer a willing seller. Your accountant or an appraisal specialist can help you in the valuation process.

Q: Why use insurance as the funding mechanism for the buy-sell agreement? Aren't there other options available?

A: Insurance is generally the best funding vehicle for buy-sell agreements because the proceeds become available when needed – upon the death or disability of a business owner. Additionally, this type of funding provides cash for the purchase obligation cost effectively. When properly structured, death benefit proceeds pass income tax-free to the surviving business owners or to the business itself. The disability income proceeds pass tax-free up to the disabled business owners' basis in the business. The excess income will be treated as either capital gains or dividend depending on which type of buy sell arrangement is best for all parties.

Alternative funding methods, such as bank loans or installment purchases, may put a strain on the business just when it has been hit with the loss of a key owner. A reserve or sinking fund may be inadequate because the death or disability of an owner may occur before sufficient funds are accumulated.

Would your business benefit from buy-sell planning?

Questions you should answer		
Are there other owners of your business?	❑ Yes	❑ No
Has a contingency plan been prepared that maps out the continuation of your business in the event of your death or disability?	❑ Yes	❑ No
Do you have family members who are actively involved in your business?	❑ Yes	❑ No
Has a successor management team been selected?	❑ Yes	❑ No
Has a business continuation plan been discussed with family members and key employees?	❑ Yes	❑ No
If one of your business partners dies or becomes disabled, do you want to continue the business with the deceased or disabled partner's heirs?	❑ Yes	❑ No
Will your business partners look after your family's financial needs?	❑ Yes	❑ No
Will there be enough cash to settle your estate expenses?	❑ Yes	❑ No
Will your family receive a fair price for your share of the business?	❑ Yes	❑ No

Get started today!

If your answers to any of these questions cause you concern about the continuity of your business, you should consider a buy-sell agreement.

Why Ohio National?

You have a number of excellent companies to choose from for your business insurance. Ohio National is in the top rank of life insurers serving the small business market:

Financially strong company

Ohio National is a financially secure and highly rated company. You can count on Ohio National to deliver value and security today and for years to come. See ohionational.com for the latest annual report and company ratings.

Mutual heritage

Because of Ohio National's mutual company heritage, the management view is long term. Thus, we are free from the pressure for short-term results – driven by the 90-day earnings cycle, for example – that stock companies (including most major insurers) are under. Ohio National's emphasis has always been on prudent, conservative long-term management in the best interests of our policyholders.

Outstanding professional representation

More than 10,000 financial professionals across the country have chosen to contract with Ohio National. They are well trained, experienced financial professionals who, in many cases, have multiple licenses and professional designations in financial services.

High-performance products

Ohio National has a long tradition of maintaining remarkably competitive financial products including individual life and disability income insurance.

Life changes. We'll be there.®

Our mission is to make a difference in your life by helping you achieve financial security and independence today – and for generations to come.

For more information, contact your Ohio National financial professional today.

Information concerning the taxation of benefits, taxation of the sales proceeds of the business, and the deductibility of premium payments is based upon our understanding of current tax law. Individual situations may vary, and the tax law is subject to change. Therefore, it is important that you consult with your tax advisor concerning all the matters. In addition, you should consult with your legal advisors concerning drafting a buy-sell agreement that is suitable for your needs.

Products are issued by The Ohio National Life Insurance Company and Ohio National Life Assurance Corporation. Product, product features and rider availability vary by state. Guarantees are based upon the claims-paying ability of the issuer. Disability income insurance not available in CA. Issuers not licensed to conduct business in NY.

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