Basic Advantages and Disadvantages of Redemption vs. Cross-Purchase Buy-Sell Agreements

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Redemption Buy-Sell Agreements

Advantages	Disadvantages
- The company uses its monies (or life insurance proceeds) to purchase the deceased owner's equity	- The company purchases a deceased owner's equity, which equity is retired; therefore, the surviving owner's tax basis in his equity remains the same; this will result in larger taxable capital gains when the surviving owner sells his equity
- The life insurance policies are owned by the company and the company is the beneficiary of the life insurance proceeds; therefore, only one policy is needed for each owner of the company	- State law may prohibit the company from purchasing the deceased owner's equity if it lacks sufficient funds to do so, but this can be addressed by purchasing life insurance and/or paying for the equity over a period of time (such as three to five years)
- The insurance premiums are paid by the company; therefore, any difference in the amount of the premiums of the policies due to the different ages or health condition of an owner is usually not important	- The life insurance proceeds are subject to the claims of the company's creditors
	- Although life insurance proceeds are not taxable, in a C corporation, the receipt of such proceeds may result in the company paying the alternative minimum tax
	- The premiums paid by the company are not deductible as business expenses

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Cross-Purchase Buy-Sell Agreements

Advantages

- The surviving owner receives a step-up in tax basis in the equity that he purchases from the deceased owner, which will result in a smaller taxable capital gain when he sells his equity

- The life insurance proceeds are received by the surviving owner and, therefore, are not subject to the claims of the company's creditors

- The life insurance proceeds received by the surviving owner are not taxable

Disadvantages

- The surviving owner uses his own monies to purchase the deceased owner's equity, but this can be addressed through the purchase of life insurance or a cash distribution from the company to the surviving owner

- An owner must have a policy on the life of each other owner; if there are more than two owners, there will be a need for many policies (for example, with three owners, there is a need for a total of six policies; each owner would have a policy on the two other owners)

- Each owner must pay the premiums on the policies individually rather than having the company pay the premiums; however, the company can increase the compensation of the owners to "reimburse" them in the amount of the premiums

- The younger and/or healthier owners likely will pay larger premiums for the life insurance policies of the older and/or unhealthier owners

- There is a risk that the surviving owner will not use the life insurance proceeds to purchase the deceased owner's equity; however, this can be addressed by a lawsuit for specific performance of the buy-sell agreement

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