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Interstate Insurance Product Regulation Commission (IIPRC)
Product Standards Committee (PSC)
444 North Capitol Street, NW
Hall of the States, Suite 700
Washington, DC 20001-1509
comments@insurancecompact.org

RE: Draft *Individual Disability Buy Sell Policy Standards*

Members of the Product Standards Committee:

The American Council of Life Insurers ("ACLI") appreciates this opportunity to provide the following responses to the questions that are embedded in the draft *Individual Disability Buy Sell Insurance Policy Standards*.

## Section 3.B – Definitions and Concepts

(2) Activities of Daily Living (ADLs) - The PSC questioned the need for the definition of Activities of Daily Living and whether it was needed. A PSC member noted that it was listed as a trigger for benefits in the definition of Disability in (12) (b).

Question for ACLI - Did you intend to delete all the references to ADLs from the Buy-sell standard? If so, can we delete the definition of ADL and the reference to ADLs as a trigger for benefits in the definition of disability in (12)(b)?

ACLI Response - ADLs were included as a definition within the draft buy-sell standards to allow for flexibility should a disability carrier wish to include ADLs as an alternate or optional trigger for a disability within an individual disability buy-out policy. In addition, individual disability buy-out policies provide for such flexibility to allow for those buy-sell agreements that may include ADLs as a trigger for disability within a buy-sell agreement's definition of disability. Buy-sell agreements will frequently incorporate, refer to, or defer to the definition of disability within a disability buy-out policy.

We note that ADLs are included within IIPRC-DI-H11-POL *Standards For Individual Disability Income Insurance Policies* adopted August 3, 2018 as a definition at B(1)(pg. 6) and as an optional or alternative benefit trigger at (13)(b)(pg. 8) (i.e. "Other Disability benefit triggers may include: The insured is unable to perform a specified number of Activities of Daily Living. The insurance company shall not require this benefit trigger to require the inability to perform more than two Activities of Daily Living:"). In a similar manner, the drafted buy-sell standards have incorporated this flexibility into the definitions and as an optional benefit trigger ("may include").

<u>(3) Aggregate benefit amount</u> - A PSC member asked why buy-sell benefits would be paid on a monthly basis.

<u>Request for ACLI</u> - It would be helpful if an ACLI member could provide some background on monthly benefits versus lump sum benefits such as why a business would choose monthly benefits and/or a combination of monthly and lump sum benefits.

<u>ACLI Response</u> - Individual disability buy-out policies do not provide for monthly benefits such as those that are paid under the terms and conditions of individual disability income insurance policies. Recall that the individual disability buy-out policy is merely a funding mechanism to buy out all or a portion of the disabled (or in some cases deceased) partner's interest in the business entity. The purchase price of the partner's interest is a fixed amount determined at a specific moment in time (i.e., after the partner has been disabled for a specific period of time). The purchase price of the disabled partner's interest is usually determined by the terms of the buy-sell agreement as a percentage (corresponding to the disabled partner's interest) of the business' fair market value, appraised value, or other agreed upon amount by all partners utilizing the business' financials evaluated by CPAs or other agreed upon experts.

Historically, individual disability buy-out polices have provided for a "lump sum" benefit payment utilized by the business to buy-out a portion of or all the disabled partner's interest. The terms, conditions, and provisions of disability buy-out polices have evolved over time as buy-sell agreements have evolved over time to allow for flexibility of installment payments on the lump sum amount. Most disability buy-out policies now allow for payment of a lump sum benefit as a lump sum, a down-payment followed by subsequent monthly installment payments, or monthly installment payments over a specific period. The latter two options merely provide installment payment options on the lump sum benefit amount and therefore are not monthly benefits.

(5) Benefit factor - PSC members still had questions about adding benefit factor to the definition of benefit period.

<u>Question for ACLI</u> - PSC members asked if there should be a separate definition for benefit factor. The Compact office noted that some state-approved policies had separate definitions for monthly installment period.

<u>ACLI Response</u> - To clarify the distinction between benefit factor and benefit period, we have drafted the following definitions for the Product Standards Committee's review:

"Benefit Period" means, subject to satisfaction of all policy terms and conditions by the owner or assignee, the length of time or number of periodic payments for which a Disability Buy-Sell benefit may be paid.

“Benefit Factor” means, subject to satisfaction of all policy terms and conditions by the owner or assignee, the number of payment installments that should be made when monthly or combination benefits are selected.

(6) Business/Company - PSC members questioned the need to add “company” as it was confusing as to whether it meant the business or the insurance company.

Question for ACLI - If the definition was left as business, would that cause a problem?

ACLI Response - Although “Company” was included within the definition to allow for flexibility as some carriers utilize “Company” in their disability buy-out polices in defining the business entity of the covered employee/partner, removal of the word “Company” from the draft buy-sell standards is fine if the PSC believes it will avoid confusion.

(7) Buy-sell agreement - PSC members asked if they could see a sample of a buy sell agreement.

Request for ACLI - It would be helpful if ACLI could provide a sample buy sell agreement.

ACLI Response - We have attached a sample “Corporate Cross Purchase Buy-Sell Agreement”.

(12) Partial and residual disability - PSC members asked if the reference to meeting the definition of partial and residual disability should be removed as not applicable for these products. They also asked if the reference to using ADLS as a benefit trigger be removed in (12) (b)

Question for ACLI - The PSC asked if the buy sell policy only covers total disability, should the reference to partial and residual disability in the definition of “disability” be deleted.

ACLI Response - The references to Partial Disability and Residual Disability within the definition of “Disability” or “Disabled” were incorporated to allow for future flexibility to the definition, such that the insured need not be fully disabled to trigger a partial or residual benefit. The percentage benefit and terms of payment would be more fully defined in the disability buy-out contract.

(12(b) Activities of Daily Living - See the question under the definition of Activities of Daily Living. If ADLs are not being used, the PSC suggests (12)(b) could be deleted.

Question for ACLI - If ADLs are not being used as benefit triggers, can (b) be deleted?

ACLI Response - See our response to (2) above.

(14) Fair market value - PSC members asked why this definition was needed.

Question for ACLI - PSC did not see this term in state-approved products and ask why this definition is needed.

ACLI Response - Please refer to the attached sample “Corporate Cross Purchase Buy-Sell Agreement” and our response to 3 above. Fair market value is an important concept to buy-sell agreements and generally is used in determining the purchase price of the disabled business owner’s interest in the business. Fair market value is incorporated into the draft standards as disability buy-out policies are frequently referenced in buy-sell agreements. Does the PSC feel that the terminology is understood well enough not to be defined in the standards?

(19) Maximum benefit amount - PSC members asked why this definition was needed.

Question for ACLI - PSC members questioned why there needs to be a definition of aggregate benefit amount and maximum benefit amount.

ACLI Response - Aggregate benefit amount defines the total benefit payable (whether lump sum or in monthly installments of the lump sum or a combination thereof) as indicated in the disability buy-out policy. The aggregate benefit amount is the amount of coverage selected by the owner of the disability buy-out provided at policy issue. The Maximum benefit amount is the actual benefit payable to the owner of the disability buy-out policy and takes into consideration the purchase price of the disabled business owner's interest in the business vis-à-vis the actual value of the business based on the fair market value (or appraised value if specified in the buy-sell agreement) of the business as of for example the date of the disabled partner's disability.

Section 3.F. - Permissible Limitations or Exclusions

(3) Benefit Reduction On Account of Other Disability Buy-Sell Coverage - The PSC identified one question regarding Permissible Limitations. When would the Permissible Limitations Benefit reduction on account of other disability buy-sell coverage occur and why is this provision needed?

Question for ACLI - PSC members questioned when this would occur and the need for this provision.

ACLI Response - The purpose of Buy-Sell insurance is to fund the buy-out of the disabled owner's interest in the business. Therefore, if the insured is covered under multiple disability buy-out policies, there needs to be an appropriate mechanism to reduce benefits payable in the event that the total coverage exceeds the actual value of the business at the time the claim occurs. Coordination of benefits is critical for this. As for when it would occur, here's a hypothetical example:

- An insured is covered under a small Buy-Sell policy purchased early in the life cycle of the business. The business grows over time and so a second buy-sell policy is put in place to reflect the new business value. After a few poor sales years, the value of the business now has decreased, and the insured now becomes disabled. At the time of a disability claim, the benefits on both policies should decrease proportionately to reflect the new current value of the insured's ownership interest.

Thanks again for this opportunity to provide responses to your questions and we look forward to working with you as these standards are developed and adopted. If you have any questions, feel free to contact me at waynemehlman@acli.com or 202-624-2135.

Sincerely,

Wayne A. Mehlman

Wayne Mehlman
Senior Counsel, Insurance Regulation

**Sample**

# Corporate Cross Purchase
# Buy-Sell Agreement

This sample agreement has been prepared as a guide to assist attorneys. **As a sample agreement, this document cannot be used as a final draft without modification and consultation with the client's attorney.** Clients must seek legal counsel to modify the agreement for the client's particular circumstances. The Client's attorney is responsible for the final draft of the actual agreement.

This sample agreement is illustrative for corporations (1) taxed as regular ("C") corporations, or (2) for those taxed as S corporations.

Death, disability, and retirement are included as mandatory purchase and sale triggering events.

Under this Agreement, insurance funding should be structured with each Shareholder being the premium payer (paying the premium as a non-deductible expense), owner, and beneficiary of a life insurance and/or disability buyout policy on each of the other Shareholders. Adverse income tax outcomes may occur if this ownership and beneficiary arrangement is not followed.

The Agreement is written to build a very strong contractual requirement to use the insurance proceeds to complete a purchase and sale of a deceased or disabled Shareholder's interest in the Corporation.

A cross purchase buy-sell design is generally adopted when (1) there are only two business owners; (2) when an increase in ownership cost basis for the surviving owner is a primary goal; or (3) when there are multiple owners and funding of buy-sell purchase obligations is provided through an external entity, such as a general partnership. Other factors may also be important in selecting a buy-sell plan design.

**Sample document only – clients must consult legal counsel**

# Corporate Cross Purchase Agreement

This Agreement, entered into this __________ day of ________________, 20__, by and between __(Name)_______________, and _(Name)_______________, hereafter called the "Shareholders".

**Witnesseth**:

**Whereas**, the Shareholders own all the stock of (Name of Company), a _(state under which the Corporation is organized)_____ corporation with its principal place of business located at (Address)________________ . The Shareholders own the following number of shares of stock:

___(Name)_____________, ___Shares

___(Name)_____________, ___Shares

___(Name)_____________, ___Shares

**Whereas**, the Shareholders wish to make all shares of Corporation stock, and any stock acquired hereafter, subject to the terms of this Agreement;

**Whereas**, the Shareholders, for their mutual protection and continuous successful management of the Corporation, wish to provide for the purchase and sale of all of a Shareholder's shares of stock upon his/her death, disability, or retirement;

**Whereas**, it is the intent of the Shareholders that this Agreement shall supersede and be given precedence over any previously drafted and executed buy-sell agreement, or any other Corporate document that may also include buy-sell provisions; and

**Whereas**, it is also the intent of the Shareholders to secure the purchase obligations of this Agreement through life insurance, and disability buy-out insurance, to provide all or a substantial part of the purchase price when needed to carry out a purchase and sale under this Agreement upon the death or disability of a Shareholder.

**Now, therefore**, in consideration of the mutual covenants to buy and sell and the performance thereof expressed herein by the parties, each of the Shareholders does hereby bind himself/herself, his/her heirs, executors, administrators and assigns, and all hereto agree as follows:

1. **Restriction on stock transfer.** No Shareholder shall gift, sell, assign, transfer, pledge or dispose of any of his/her respective stock in the Corporation by sale or otherwise, except as provided in this Agreement. Any transfer in violation of this, or any other provision of this Agreement, shall be null and void.

2. **Sale during lifetime to a non-shareholder.**

   **A.** In the event a Shareholder receives a bona fide offer from a third party to purchase his/her shares, and the Shareholder desires to accept such offer, the Shareholder shall give written notice to the Corporation and other Shareholder(s) of the price and terms of the proposed purchase. Such written notice shall be deemed an offer by the transferring Shareholder to sell to the other Shareholder(s) (first option to purchase), and then to the Corporation (second option to purchase), at the price and terms provided in Articles 7 and 8 of this Agreement.

   **B.** Each other Shareholder(s) shall have the right to purchase such portion of the stock offered for sale as the number of shares owned by each Shareholder bears to the total number of shares owned by all Shareholders, exclusive of the shares owned by the offering Shareholder.

   **C.** If a Shareholder(s) waives his/her right to purchase a portion of the shares, the other Shareholders who exercise their right to purchase a portion of the shares shall have the right to purchase the shares over which the right to purchase has been waived in such proportion as the number of shares owned by each Shareholder exercising his/her right to purchase bears to the total number of shares owned by all Shareholders exercising their right to purchase.

   **D.** If the offer to sell to the other Shareholder(s) has been rejected or has not been accepted within _____ days after the offer was made, then the Corporation shall have the right to purchase any remaining shares. If the Corporation or Shareholders or some combination of them do not exercise their right to purchase all of the stock offered for sale within ____ days after the initial offer is made, then the Shareholder desiring to sell shall have the right to sell to such other person, entity, or institution; provided, however, that the purchase price shall not be less than that established under this Agreement without first offering it to the other Shareholder(s) and then to the Corporation, at such lesser price, following the procedure outlined above.

   **E.** Notwithstanding any provisions to the contrary, if the Corporation has elected to be treated as an S Corporation, each Shareholder agrees that he/she will not, without the written consent of the other Shareholder(s), make any transfer of stock by gift, sale, exchange or otherwise to any person or entity not eligible to own stock of an S corporation.

**3. Sale of stock upon death.**

**A.** Upon the death of a Shareholder, the surviving Shareholder(s) shall purchase, and the estate of the deceased Shareholder shall sell, all of the deceased Shareholder's stock in the Corporation, now owned or hereafter acquired. Each of the remaining Shareholders shall purchase such portion of the deceased Shareholder's stock as the number of shares owned by each Shareholder bears to the total number of shares owned by all Shareholders, exclusive of the shares owned by the deceased Shareholder.

**B.** The sale shall occur within such time as the parties may agree, but in no event shall the sale begin more than _____ days after the qualification of the deceased Shareholder's legal representative. The purchase or sale price and the terms of payment for such stock shall be determined in accordance with the provisions of Articles 7 and 8 of this Agreement.

[***Note to Counsel:*** The below paragraph may be helpful for business owners residing in states that follow community property or marital property ownership regimes.]

**C.** Upon the death of a Shareholder’s spouse, if the deceased spouse’s community [or marital] property interest in the Shareholder’s stock is not devised or otherwise passed to the Shareholder, then the Shareholder of the deceased spouse shall purchase, and the estate of the deceased spouse shall sell, all of the deceased spouse’s community [or marital] property interest in the Corporation from the deceased spouse’s estate at the same price and terms applicable to any other sale under this Agreement.

**4. Sale of stock upon determination of disability.**

**A. Purchase obligation.** In the event a Shareholder who is also an employee of the Company, as determined by the Company and by Company payroll practices (hereafter referred to as a “Shareholder/employee”) becomes “disabled” under either of the below definitions, then the remaining Shareholder(s) shall purchase, and the disabled Shareholder/employee shall sell, all of the disabled Shareholder/employee’s shares in the Corporation now owned or hereafter acquired. Purchase of the disabled Shareholder/employee’s interest in the Corporation shall occur in accordance with the provisions of Articles 7 and 8 of this Agreement.

**B. Definition of disability.** For purposes of this Agreement, the terms “disabled” or "disability" shall mean either:

**(1)** An insured Shareholder/employee is disabled under the definition in, and for the elimination period specified in the individual disability buy-out policy owned by the other Shareholder(s) on an insured Shareholder/employee and listed in Schedule B or,

**(2)** If there is no disability buy-out policy in force on a Shareholder/employee at the time a potential disability occurs, then a determination that the Shareholder/employee is unable to perform the required duties of his/her job for a period of [180 or 365] consecutive days, shall be made by a licensed physician, agreed to by all Shareholders, including the potentially disabled Shareholder/employee.

**(a)** The physician shall be agreed upon and contracted for services no later than fifteen (15) calendar days from the date ("Notice of Potential Disability Date") that a Shareholder/employee provides written notice to the Corporation and other Shareholder(s) of a potential disability event. Within thirty (30) days after examination, the physician shall communicate his/her decision to the parties.

**(b)** If the parties are unable to agree on a physician in the time allowed, then each party will select and contract with a physician and the two physicians shall select a third. The third physician shall be agreed upon and contracted for services no later than forty-five (45) days after the first physician is selected. A binding determination of disability will be reached if two of the three physicians agree that the Shareholder/employee is disabled no later than thirty (30) days of the last physician examination.

**(c)** The Shareholders agree that the Corporation shall pay for all physician services engaged in reaching a determination of disability under this Agreement.

*[**Note to Counsel:** The use of a mandatory disability buyout provision should be carefully considered, taking into account the circumstances of the shareholders. In the case of a founder of a family business, for example, or a shareholder who is not actively involved in the management of the* business*, the parties might not intend to force a buyout upon disability. This sample agreement is drafted to include a buy-sell trigger for disability only for shareholders who are also considered employees of the Corporation.]*

**5. Sale of stock upon retirement of a shareholder/employee.**

**A.** Upon a Shareholder/employee's retirement (as defined herein below), the remaining Shareholder(s) shall purchase, and the retiring Shareholder/employee shall sell, all shares owned by the retiring Shareholder/employee.

**B.** “Retirement” for a Shareholder/employee is defined as a voluntary termination of employment at any time after attaining age ___, with at least ___ years of service to the Corporation. For a Shareholder/employee with less than ___ years of service to the Corporation, “retirement” is defined as a voluntary termination of employment at any time after attaining the age of ___ . Unless waived by the Corporation and all other Shareholder(s), a retiring Shareholder/employee shall give at least ___ month’s written notice of his/her intent to retire.

**6. Events or actions creating a purchase option.** An optional purchase will occur as described below upon the occurrence of any of the following events, or the expectation of a transfer of shares arising from any of the below events:

**A.** In the event of a transfer resulting from a marital property settlement pursuant to a legal separation, divorce or marriage dissolution action of a Shareholder, the affected Shareholder shall be provided an option to purchase such shares for ___ days following the later of the date of the transfer or the date of notice of the transfer. If the affected Shareholder does not elect to purchase the shares, the other Shareholder(s) shall be provided a purchase option for ___ days following the expiration of the divorcing or separating Shareholder’s option. If the other Shareholder(s) does not elect to purchase such shares, then the Corporation is provided a purchase option with respect to any unpurchased shares for ___ days following expiration of the other Shareholders’ purchase option.

**B.** In the event of any of the following occurrences, the unaffected Shareholder(s) is provided a purchase option for ___ days following the later of the event or notice to the other Shareholder(s) of the event. If the other Shareholder(s) does not elect to purchase such shares, then the Corporation is provided a purchase option for all of the events listed below with respect to any unpurchased shares for ___ days following expiration of the other Shareholders’ purchase option.

**(1)** A transfer resulting from a voluntary or involuntary bankruptcy proceeding;

**(2)** A transfer resulting from an assignment for the benefit of creditors;

**(3)** A transfer resulting from the execution of a judgment or levy against a Shareholder;

**(4)** A transfer by operation of law;

**(5)** Termination of employment for any reason other than death, disability, or retirement, including a voluntary withdrawal from business operations of a Shareholder/employee;

**(6)** Loss of a professional license for at least ___ days; or

**(7)** Conviction of a felony.

**7. Determination of purchase price.**

**A.** The purchase price for the sale of a Shareholder's interest in the Corporation under this Agreement shall be based on the Corporation's fair market value, multiplied by the ownership percentage held by the selling Shareholder or the selling Shareholder's legal representative. Fair market value for all sales shall be determined as described below in Paragraph D.

**B.** For death or retirement buy-sell purchase and sale events, corporate financial information shall be used as it exists as of the date the Shareholder dies or retires. For purchases occurring under Articles 2 (right of first refusal) or 6 (events creating a purchase option), corporate financial information shall be used as it exists upon the date the option is exercised.

**C.** In the event a purchase and sale is triggered by the disability of a Shareholder/employee, the valuation method described in this Paragraph shall be applied using Corporation financial information as it existed at the beginning of the elimination period specified in the disability buy-out policy listed in Schedule B. If there is no disability buy-out policy in place on the affected Shareholder/employee, then the valuation date for purposes of this Article shall be the Notice of Potential Disability Date as described in Article 4.

**D. Determination of fair market value.**
*[**Note to Counsel:** The sample valuation method alternatives provided below should be reviewed for financial, tax, and legal impacts prior to the selection of a method for the Agreement. Upon advice from legal and tax counsel, the Shareholders will select one valuation method for inclusion in the Agreement. Other methods of establishing a company's fair market value, not included here, may also be appropriate.]*

**Valuation method alternative one: Agreed value with appraisal backup**

Each year as part of the Corporation's annual meeting, the Shareholders shall, if possible, unanimously agree and establish the overall fair market value ("Agreed Value") of the Corporation for purposes of this Agreement after reviewing the prior year's financial statements and taking into consideration other important factors. This Agreed Value shall be added to Schedule C of this Agreement as it is approved.

If the Agreed Value has not been updated within [twelve months] [eighteen months] of the buy-sell trigger, then an appraisal process shall be used to establish fair market value. The Corporation and the departing Shareholder or his/her legal representative, may mutually agree upon an independent business appraiser. If the parties are unable to mutually agree upon an appraiser within 30 days from the date of the buy-sell trigger, the parties shall each name an independent business appraiser qualified as a Certified Business Appraiser (CBA), Accredited Senior Appraiser (ASA), CPA accredited in business valuation (CPA/ABV), or Certified Valuation Analyst (CVA). If the two appraisers cannot agree upon a value within _____ days, they shall agree upon and appoint a third appraiser within 30 days of reaching a deadlock over the Corporation’s valuation. The Corporation’s final fair market value shall be established by equally averaging all three appraised values.

In any determination of value made after the death of a Shareholder, the value of life insurance death proceeds in excess of the policy's cash surrender value at the time of the decedent's death shall not be taken into account. The Shareholders agree the appraisal process is not to include valuation premiums for control, nor discounts for lack of control or lack of marketability, in establishing fair market value. For purposes of the appraisal, real estate owned by the Corporation shall be valued at its current fair market value, determined by a current real estate appraisal, not its balance sheet value.

**Valuation method alternative two: Formula**

The following formula shall be used to establish fair market value of the Corporation:

[Insert formula here.]

For purposes of this formula valuation, life insurance death proceeds paid to the Corporation are not to be considered a corporate asset or included in the Corporation’s revenue or income.

**Valuation method alternative three: Appraisal**

The Corporation and the departing Shareholder or his/her legal representative, may mutually agree upon an independent business appraiser. If the parties are unable to mutually agree upon an appraiser within __ days from the date of the buy-sell trigger, the parties shall each name an independent business appraiser qualified as a Certified Business Appraiser (CBA), Accredited Senior Appraiser (ASA), CPA accredited in business valuation (CPA/ABV), or Certified Valuation Analyst (CVA). If the two appraisers cannot agree upon a value within _____ days, they shall agree upon and appoint a third appraiser within 30 days of reaching a deadlock over the Corporation's valuation. The Corporation's final fair market value shall be established by equally averaging all three appraised values.

In any determination of value made after the death of a Shareholder, the value of life insurance death proceeds in excess of the policy's cash surrender value at the time of the decedent's death shall not be taken into account when valuing the Corporation. The Shareholders agree the appraisal process is not to include valuation premiums for control, nor discounts for lack of control or lack of marketability, in establishing fair market value. For purposes of the appraisal, real estate owned by the Corporation shall be valued at its current fair market value determined by a current real estate appraisal, not its balance sheet value.

*[**Note to Counsel:** If business owners appear likely to have an estate tax liability at death, then best practice suggests that the buy-sell agreement be utilized to "lock-in" the value of the business for estate tax valuation purposes. The requirements to do so for a buy-sell agreement entered into or substantially modified after October 8, 1990, include the following factors:*

***(1)*** *The price must be fixed or determinable pursuant to a formula under the agreement;*

***(2)*** *The estate must be obligated to sell at death at the agreement price;*

***(3)*** *The agreement must prohibit the owner from disposing of his/her interest during life without first offering it to the other party or parties at no more than the agreement price; and*

***(4)*** *The agreement must be a bona fide business arrangement and not a device to pass the interest to the natural objects of the deceased owner's bounty without full and adequate consideration in money or money's worth;*

***(5)*** *Any agreement to acquire property at less than fair market value will be disregarded **for federal transfer tax purposes** unless, under IRC Section 2703(b), the agreement (1) is a bona fide business arrangement; (2) not a device to transfer property to members of the decedent's family for less than full and adequate consideration; and (3) has terms comparable to similar arrangements entered into by persons in an arms-length transaction. Paragraph E is not applicable to buy-sell agreements entered into prior to October 9, 1990, and not substantially modified after such date.]*

**8. Terms of purchase.**

**A. Full or partial insured purchases.**

**(1)** Upon the death or permanent disability of a Shareholder, the remaining Shareholder(s) shall promptly initiate the claims process and collection of life insurance death proceeds and/or disability buy-out benefit proceeds.

**(2)** Upon the receipt of any life insurance death proceeds (from the policy or policies listed in Schedule A of this Agreement), or disability buy-out benefit proceeds (from the policy or policies listed in Schedule B of this Agreement), by reason of the death or disability of the Shareholder, the remaining Shareholder(s) shall first apply the death or disability benefit proceeds to the purchase price of the stock in furtherance of completing a purchase and sale under this Agreement.

**(3)** In the event that the death proceeds of any life insurance, or disability buy-out benefit proceeds, owned by the remaining Shareholder(s), and made part of this Agreement by being listed on the attached Schedules A and B of this Agreement, are less than the purchase price, then the balance of the purchase price shall be paid through a promissory note in ___ equal, consecutive [monthly] [quarterly] installments, with interest set at the Prime Rate as found in the Wall Street Journal ten days before payments begin, plus 1%.

**(4)** Any excess of insurance death or disability proceeds over the purchase price shall be retained by the Shareholder/policy owner.

**(5)** In the event a disabled Shareholder/employee ceases to be disabled after his/her interest has been sold, but prior to the payment of the full purchase price, the remaining balance due to the disabled Shareholder/employee shall continue to be paid pursuant to the terms of Article 8 of this Agreement.

**B. Purchases without insurance funding.**

**(1)** For all sales taking place in the absence of insurance funding, including sales following the death or disability of a Shareholder without any life insurance death proceeds or disability benefit proceeds because coverage was not acquired for purposes of this Agreement, the purchasing Shareholder(s) shall provide a down-payment equal to __% of the purchase price, with the balance of the purchase price paid through a promissory note in ___ equal, consecutive [monthly] [quarterly] installments, with interest set at the

Prime Rate as found in the Wall Street Journal ten days before payments begin, plus 1%.

**(2)** In the event of a lifetime purchase, if the purchasing Shareholder(s) owns any life insurance policies on the life of the selling Shareholder, notwithstanding any other provisions of this Agreement, the purchasing Shareholder(s) shall transfer such policies to the seller as final consideration to complete payment of the purchase price under the installment sale described above. The fair market value of the policy (as determined following IRS income tax valuation guidance) shall be used to establish the policy's economic value for purposes of the payment.

**C. Additional payment terms.** Installment payments shall be initiated as follows:

**(1)** In the event of death:

**(a)** Where life insurance death proceeds are part or the entire purchase price, such purchase shall occur no later than [10] [30] days after the later of (1) receipt of life insurance death proceeds or (2) qualification of the deceased Shareholder's legal representative with the appropriate probate jurisdiction.

**(b)** In the event of a purchase and sale without life insurance death proceeds, such purchase shall occur no later than [10] [30] days after qualification of the deceased Shareholder's legal representative with the appropriate probate jurisdiction.

**(2)** In the event of a sale triggered by the "disability" of the Shareholder/employee (as defined at Section 4(B), above):

**(a)** Where disability buy-out insurance proceeds are part or all of the purchase price, such purchase shall occur no later than [10] [30] days after receipt of disability buy-out insurance proceeds from the insurer.

**(b)** In the event of a sale based upon a Shareholder/employee disability when not funded with disability buy-out insurance proceeds, such purchase shall occur within [10] [30] days after a final determination of disability has been reached.

**(3)** For any sale occurring during a Shareholder's lifetime, other than a sale upon disability, such purchase shall occur no later than [10] [30] days following the event giving rise to the sale.

**(4)** In the event of payment default which is not cured within ___ days, the installment note shall become due and payable in full.

**(5)** Any purchasing Shareholder shall have the right to pre-pay any or all installments prior to the actual due date without penalty.

*[**Note to Counsel:** In determining the rate of interest on the unpaid balance of the note, the parties should be aware of the provisions of I.R.C. Section 483 in determining minimum interest to be charged to avoid imputed interest.]*

**9. Transfer of stock.** Upon receipt of the purchase price in cash and/or notes, as provided in this Agreement, the selling Shareholder, or his/her legal representative, shall transfer the stock to the purchasing Shareholder(s).

**10. Insurance on the shareholders' lives.**

**A.** The Shareholders shall apply for, and subject to underwriting approval, be the owner and beneficiary of life insurance and/or disability buy-out insurance on the life/lives of the other Shareholder(s). The Shareholders agree to provide their consent to be insured and to cooperate in all manner necessary to obtain agreed upon life and/or disability coverage, and any life or disability coverage to be acquired in the future.

**B.** To secure its continued performance under this Agreement, the Shareholders shall maintain during the term of this Agreement the amount of life insurance death proceeds and disability benefit proceeds posted to Schedules A and B, until such amount is modified by unanimous agreement of the Shareholders.

**C.** The Shareholders are hereby authorized to purchase, from time to time, additional insurance on the lives of any parties to this Agreement, or upon the life of anyone who may hereafter become a party to this Agreement. The Shareholders shall possess the same rights in any new policies as exist with respect to previously issued policies.

**D.** All life insurance policies pertaining to this Agreement shall be listed on Schedule A attached hereto. All disability buy-out policies pertaining to this Agreement shall be listed on Schedule B attached hereto.

**E.** The Shareholders shall pay the first and all subsequent premiums as they become due. If so requested, a Shareholder must give proof of payment to the insured within _____ days after the due date of the premium. In the event the premium is not paid within _____ days after its due date, the insured may make the payment, which shall be considered a loan to the policy owner and in which event the insured shall be reimbursed by the policy owner.

**F.** Each Shareholder agrees to take all necessary actions to allow disclosure of information to the insured pertaining to the policies insuring his/her life. Any life insurance company that has issued an insurance policy listed on Schedule A or Schedule B (attached to this Agreement) is authorized and directed to give the insured Shareholder, upon receipt of his or her written request, any information on the status of the insurance policy(s) on his or her life.

**G.** Any party to this Agreement owning life insurance on another Shareholder, shall not surrender, execute any loans against, impair or in any manner encumber any of the policies posted to Schedules A or B of this Agreement without the written consent of the Shareholder who is the insured on said policy(s), except that the policy owner may exercise any dividend options or dividend rights provided by any policy without obtaining the consent of the insured or any other parties to this Agreement.

**H.** Upon the death of all Shareholders as provided in Section 16. B., life insurance death proceeds acquired for purposes of this Agreement shall not be used to complete purchase obligations under this Agreement and shall remain the property of the rightfully determined beneficiary.

**11. Right to purchase life insurance.**

**A**. Upon the death of a Shareholder, the surviving Shareholders(s) shall have the right to purchase, within _____ days after the transfer of the deceased owner’s shares, all contracts of life insurance on his/her life appertaining to this Agreement and which were owned by the decedent.

**B**. In the event a Shareholder sells all of his/her stock in the Corporation during his/her lifetime for any reason, then the selling Shareholder(s) are provided an option within ___ days after the transfer of shares, to purchase all contracts of life insurance on their respective lives owned by another Shareholder for purposes of this Agreement.

**C**. In the event the Agreement is terminated for any reason or a sale of the Corporation to an outside buyer occurs, then each Shareholder is provided an option within ____ days after termination of the Agreement or completed sale of the Corporation to an outside party to purchase all contracts of life insurance owned by another Shareholder for purposes of this Agreement.

**D.** If an installment sale of a Shareholder's interest in the Corporation is occurring for any reason, the Shareholder/insured's option to purchase life insurance on his or her life under the circumstances described above in B., shall be deferred until the installment sale is completed, unless the policy is transferred to the insured as final payment to complete the sale of an insured's interest in the Corporation.

**E.** Before a Shareholder/policy owner may sell, surrender, lapse or otherwise dispose of a policy acquired for purposes of this Agreement, the policy owner shall provide ___ days' notice of its intent to the insured Shareholder. Upon receipt of this notice, the insured Shareholder shall have ___ days to purchase the policy on his/her life from the policy owner.

**F.** If any of the above options to purchase said policy(s) are not exercised, then each Shareholder/policy owner shall have the privilege of holding or disposing of said policy(s) at their discretion.

**G.** In all circumstances above where a policy may be purchased, the purchase price of the policy shall be as of the date of the purchase, or the policy's most recent monthly anniversary, the policy's fair market value following the guidance of Revenue Procedure 2005-25.

*[**Note to Counsel:** The measurement of fair market value of a life insurance policy varies by the type of policy. IRS Revenue Procedure 2005-25 was not directed at transactions involving a sale or exchange of policies between shareholders; however, it does address a means of determining fair market value for other purposes. It is offered here as a suggested standard for determining policy value. The insurance carrier who issued the policy is in the best position to provide guidance on the fair market value of one of its policies.]*

**H.** On payment of the policy's purchase price by the purchaser, the Shareholder/policy owner shall execute whatever documents and forms as may reasonably be required by the insurer to effect the complete transfer of title to the policy to the purchaser.

*[**Note to Counsel:** For many years it has been customary for insured purchase agreements to grant the insured the right to purchase the policies on his/her life pertaining to the agreement. However, Revenue Ruling 79-46, 1979 - I.R.B. 17, held that an employee's contractual right to buy a life insurance policy in his/her life, owned by the business, is an incident of ownership under I.R.C. Section 2042. This ruling did not involve a policy pertaining to a buy-sell agreement.*

*In Estate of John Smith v. Commissioner, 73 T.C. 307 (1979), acq. in result, 1981-1 C.B. 2, the Tax Court held that the insured's contingent purchase option was not an incident of ownership. Also, in Letter Ruling 8049002 the IRS ruled that where a shareholder had the right to purchase the policies on his life if he ceased being a shareholder, such contingent purchase option was not an incident of ownership. Accordingly, Revenue Ruling 79-46 may be of doubtful validity. Even assuming the ruling's validity, it should not result in inclusion of both the insurance proceeds and the decedent's interest in the business in the gross estate. Estate of John T. Mitchell, 37 B.T.A. 1 (1938), acq. 1938-1C.B.20; Estate of Ray E. Tompkins, 13T.C. 1954 (1949), acq. 1950-1C.B. 5.]*

12. **Disposition of disability insurance.** Upon the death of a Shareholder, the surviving Shareholder(s) shall have the right to exercise within _____ days after the transfer of the deceased Shareholder's stock, any exchange privilege provision or transfer of ownership provision, according to the terms contained in all disability buy-out contracts of insurance on his/her life appertaining to the Agreement and which were owned by the decedent.

    In the event a Shareholder sells all of his/her stock in the Corporation during his/her lifetime, for any reason, the insured Shareholder shall have the right to exercise any exchange privilege provision or transfer of ownership provision according to the terms contained in the disability buy-out insurance policy subject to this Agreement. If the insured does not exercise this right within _____ days after any of the above events occurs, the current policy owner shall have the sole right to dispose of the disability buy-out insurance policy subject to this Agreement.

    In the event of termination of this Agreement, or a sale of the Corporation occurs, then the insured Shareholders shall have the right to exercise any exchange privilege provision or transfer of ownership provision according to the terms contained in the disability buy-out insurance policy subject to this Agreement. If any insured does not exercise this right within _____ days after any of the above events occurs, the policy owner shall have the sole right to dispose of the disability buy-out insurance policy subject to this Agreement.

13. **Endorsement of stock certificate.** Upon the execution of this Agreement, the stock certificates shall be surrendered to the Corporation for the affixation of the following endorsement:

    "This certificate is transferable only upon compliance with provisions of an Agreement dated _____, 20 _____."

    Following the endorsement of the certificates, such certificates shall be returned to the Shareholders. Any stock issued to a Shareholder subsequent to the date of this Agreement shall carry the same endorsement.

14. **Execution of instruments to effect the terms of the agreement.** The parties hereto, for themselves, their heirs, executors, administrators, successors and assigns, agree to execute any and all instruments necessary to carry out the terms of this Agreement.

15. **Amendment or alterations.** This Agreement may be amended or altered in whole or in part at any time by filing with this Agreement a written instrument setting forth such changes and signed by the Shareholders who are parties to this Agreement.

16. **Termination.** This Agreement shall terminate upon the occurrence of any of the following events:

    **A.** Dissolution, bankruptcy or insolvency of the Corporation; or

    **B.** Death of all Shareholders within a period of _____ days; or

    **C.** Written and signed mutual agreement of the Shareholders; or

17. **Notice.** All notices, including offers or acceptances, shall be deemed received, if provided in writing and delivered in person to the other party, or mailed by certified or registered mail to the last known address of that party.

18. **Remedies for failure to perform.** If a party to this Agreement defaults or fails to complete his/her obligations under this Agreement, then the offended party may, at his/her option, seek damages, or obtain specific performance of the Agreement from a court of competent jurisdiction.

19. **Liability of insurer.** It is understood by the parties to this Agreement that in issuing policies of insurance pursuant to this Agreement, [Insurance Company] shall have no liability except as set forth in the policies. Said Insurer shall not be bound to inquire into or take notice of any of the covenants herein contained as to policies of insurance, or as to the application of the proceeds of such policies. Rights under a policy may be exercised during the life of the Insured pursuant to the provisions of the policy. Upon payment by said Insurer pursuant to the terms of any policy, the Insurer shall be discharged from all liability without regard to this Agreement or any amendment thereto.

20. **Governing law.** This Agreement shall be governed by the laws of the state [Commonwealth] of ____________________.

21. **Agreement to mediate disputes.** Any Shareholder shall have the right to require that any claim or dispute arising under or relating to this Agreement that cannot be settled through direct

negotiation shall be subject to a mediation proceeding under rules established by the American Arbitration Association. All parties agree to try in good faith to settle any claim or dispute subject to mediation through the mediation process before resorting to arbitration.

22. **Binding arbitration.** Any claim or dispute arising under or related to this Agreement not settled by direct negotiations or mediation shall be settled by binding arbitration in accordance with the rules of the American Arbitration Association. Any decision by the arbitrator shall be final and binding on each and all parties and their personal representatives.

**In witness whereof**, the parties hereto have set their hands and seals the day and year above written.

(Formalities of execution will
be governed by local law and
should be in accordance therewith.)

_________________________
(Signature of Shareholder)

_________________________
Name (print)

_________________________
(Signature of Shareholder)

_________________________
Name (print)

**Spousal Consent and Acceptance of Agreement**

I, _____(Name)______, spouse of ____(Shareholder )___, have read the foregoing Agreement. I have also been given the opportunity to consult with legal counsel. In addition, I have been informed of the Corporation's general financial condition.

I agree to the provisions of said Agreement governing the transfer of Shareholders' stock.

I further agree that the provisions of this Agreement shall be binding on me for any and all purposes while this Agreement remains in effect.

This acceptance is executed by me at the same time my spouse is executing the said Agreement.

______________________________ ______________________________

(Signature of Spouse) Name (print)

______________________________

(Date)

**Life insurance policies**

# Schedule A

All policies listed below are for the sole and express purpose of funding purchase and sale obligations under the Agreement to the extent of the purchase price established by the Agreement. Each policy owner warrants that he/she is also the named beneficiary he/she owns.

| | | | | |
|---|---|---|---|---|
| ____________ | ______________ | ________________ | ____________ | ___________ |
| Insured | Policyowner | Insurance Co. | Policy No. | Death Benefit |
| ____________ | ______________ | ________________ | ____________ | ___________ |
| Insured | Policyowner | Insurance Co. | Policy No. | Death Benefit |

**Disability insurance policies**

## Schedule B

All policies listed below are for the sole and express purpose of funding purchase and sale obligations under the Agreement to the extent of the purchase price established by the Agreement. Each policy owner warrants that he/she is named as the recipient of the policy's disability buy-out benefit proceeds.

| Insured | Policyowner | Insurance Co. | Policy No. | Amount |
|---|---|---|---|---|
| Insured | Policyowner | Insurance Co. | Policy No. | Amount |

Statement of Agreed Value

## Schedule C

| Date Posted | Agreed Value | Initials of Shareholders |
|---|---|---|
| | | |
| | | |
| | | |
| | | |
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