John Hancock INSURANCE

Cross Endorsement Buy-Sell

CLIENT SNAPSHOT

BUSINESS PLANNING

The buy-sell plan where you own your policy

Most types of buy-sell arrangements require someone other than you to be the owner of the life insurance policy on your life. In these types of arrangements, because you do not own your policy there are some important consequences to consider:

- **If you retire or leave the business**, your partners or the business itself will own the policy on your life
- **If one of your business partners dies** and they own a policy on your life, your partner's spouse or estate will own the policy on your life
- **If your health deteriorates**, your life insurance policy is not yours for personal use

Life insurance, like any other asset, can have personal value to you as your needs change. Accordingly, you may prefer to keep that asset in your control and not have it owned by either the business or your partners.

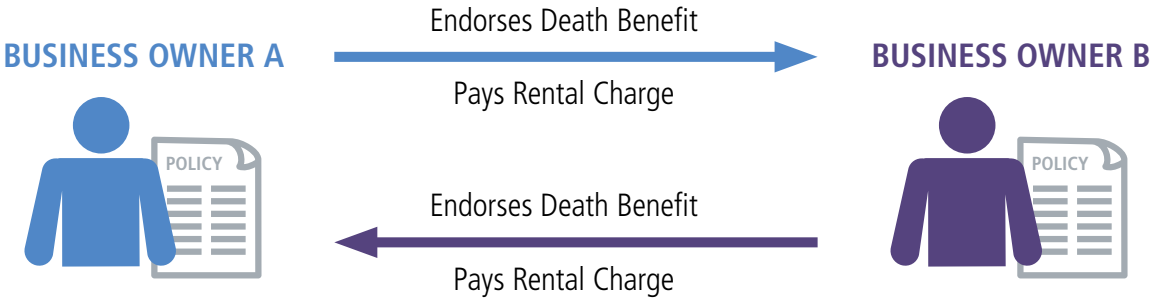
The Value of the Cross Endorsement Buy-Sell

What if there was a way to have both a funded buy-sell arrangement PLUS the flexibility and other benefits that come with owning your own policy? A cross endorsement buy-sell plan may be the answer; it is the one type of buy-sell plan that allows you to own your own policy.

The cross endorsement buy-sell plan is unique because it allows you to own your life insurance policy to cover obligations needed for the buy-sell agreement in addition to being able to provide for your own personal needs.

By owning your own permanent life insurance policy under this type of arrangement, you may be able to access the life insurance policy's cash value to fund a lifetime buy-out of the business or supplement retirement income if and when the buy-sell plan is no longer needed. Lastly, the life insurance policy death benefit can help provide financial security to you and your family beyond what is required in the buy-sell plan.

How It Works



STEP 1: You and your business partners enter into a buy-sell agreement whereby each owner agrees to buy out the other upon a "triggering event," such as retirement, disability or death. This is commonly referred to a cross-purchase agreement.

STEP 2: To help provide funding for these buy-sell obligations, you purchase a life insurance policy on your life. The death benefit on your policy is, at a minimum, sufficient to meet the needs of the buy-sell agreement.[1]

STEP 3: You enter into an agreement with your business partners to "rent" to them the amount of death benefit needed to satisfy their obligations under the buy-sell agreement. Each partner's interest in your policy is secured using a policy endorsement.

Note: These steps are duplicated with each of your partners. They will each own a life insurance policy on their own life and "rent" the death benefit to the other owners, including you.

STEP 4: Each of your business partners will pay you a rental charge annually for their share of the death benefit that is apportioned to them under the plan. The rental payment you receive from your partners generally is based on the "economic benefit value" of the death benefit being endorsed.

The economic benefit value is calculated using either a government or insurance company rate table that takes into account your age. Although these rates increase each year with age, they are generally very low in cost, and do not discriminate for gender or health. See Table 1 for sample rental charges using economic benefit rates.

TABLE 1: Annual Rental Fee on $100,000 of Death Benefit

INSURED'S AGE	BASED ON JH ALTERNATIVE TERM RATES	BASED ON IRS TABLE 2001 RATES
40	$45	$110
45	$59	$153
50	$79	$230
55	$108	$415
60	$177	$651

What Happens Next

As long as the cross endorsement buy-sell plan is in place, the amount of death benefit you rent to your partners will be paid to them at your death. Your partner(s) will then use the death benefit proceeds to buy out your interest in the business from your estate/heirs and the obligations under the buy-sell arrangement will be satisfied. Thereafter, your partners will now own your share of the business and your family will receive a cash inheritance.

The cross endorsement buy-sell plan can be terminated at any time subject to agreement. Once terminated, rental payments stop and you can use the policy exclusively for your own personal planning needs. This can be a distinct advantage compared to other buy-sell approaches where policies often must be transferred between business owners when the business terminates or there is a change of ownership.

Built-In Flexibility

As the value of the business fluctuates or ownership interests change, so too can the amount of insurance being endorsed to the other owners. **For example**, Allen and Bob are 50/50 owners of a real estate management company. Both Allen and Bob each own $1,000,000 of life insurance on their own lives and are each endorsing $500,000 of death benefit to the other for buy-sell purposes. After a recent business valuation, Allen and Bob need an additional $200,000 each to satisfy the buy-sell obligations. Pursuant to their cross endorsement buy-sell agreement, each can update the endorsement on their personal policies from $500,000 to $700,000 to reflect the appreciation of their respective business interests.

Combine With Personal Planning – A Key Differentiator

The cross endorsement buy-sell plan is unique because you own the life insurance policy on your life. Therefore you can combine personal planning with buy-sell planning to create a hybrid plan that satisfies both your personal and business insurance needs.

Interested in seeing a model of the Cross Endorsement Buy-Sell plan? Ask your advisor to request a customized proposal from John Hancock.

Under this type of arrangement you can purchase additional death benefit protection to cover personal needs. For example, if the death benefit needed for the buy-sell plan is $1,000,000 and you need $500,000 of death benefit for personal reasons, you could purchase a life insurance policy with death benefit of $1,500,000 to satisfy both your business and personal needs under one policy.

Another option is to overfund the premium on your life insurance policy to build potentially higher cash value; this cash value may then be accessed after the buy-sell arrangement ends to help provide supplemental retirement income.[2] For instance, a partner could buy a permanent life insurance policy and overfund the policy, so that at retirement they can access cash from the policy to supplement retirement income.

The Value of Life Insurance

Life insurance is often used to fund a buy-sell arrangement because the policy's death benefit can provide immediate liquidity necessary to "buy out" your interest in the business upon death, ensuring that your heirs receive a cash inheritance while allowing the remaining owners to continue to run and maintain the business. Moreover, when a permanent life insurance policy is purchased, the cash value that accrues inside the policy may be accessed in tax-efficient manner during life to help fund a lifetime buy-out of an owner – for example, at retirement.

Life insurance provides these distinct tax advantages:

1. **Tax Free Death Benefit**
2. **Tax Deferred Growth**
3. **Tax Free Access to Cash Values**

Important Considerations

- Cash flow is required to pay the permanent life insurance premiums and rental charges to your partners
- Rental charges increase with age
- Rental income may be taxable
- Accessing the life insurance policy cash value may lower the death benefit
- May not be appropriate for C and S corporation owners due to "transfer-for-value" rules.[3]

Please consult with your financial/legal/tax advisors before determining if a Cross Endorsement Buy-Sell plan is right for you.

Talk to your financial professional about creating and funding a cross endorsement buy-sell as the ultimate strategy to help with the succession and transition of your business.

1. A qualified appraisal of the business should be completed.

2. The parties to the cross endorsement buy-sell arrangement may wish to restrict access to the policy's cash value either in whole or to the extent that access does not impair the death benefit being endorsed. That is, loans and withdrawals will reduce the death benefit and cash surrender value, which may cause the policy to lapse or become insufficient to satisfy the buy-sell plan requirement. Additionally, the surrender or lapse of a policy with a loan may cause the recognition of taxable income.

3. The owners may want to consider a partnership or limited liability company (if one does not already exist) between the owners to avoid any transfer-for-value issues with respect to the cross endorsements of the policy death benefits. Clients should consult their tax advisors to discuss this issue.

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Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.

Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59 1/2.

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