

# Cross Purchase Buy-Sell Arrangements

*Proactively Planning for the Transition of Your Business*



**Prepared For:**

Company

**Presented By:**

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## *Buy-Sell Arrangements*

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Figures used in this program illustrate various benefit/retirement planning concepts, which are based upon both assumptions and data provided by you, the client. Your furnishing of accurate data will help enhance the value of this analysis. However, all assumed growth rates for assets are based upon information provided and assumed by you and are not a guarantee of the future performance of the life insurance policy. Please review the assumptions page for accuracy of information.

This supplemental illustration assumes that the currently illustrated non-guaranteed elements will continue for all years shown. This is unlikely to occur and actual results may be more or less favorable than those shown. The actual consequences of a particular planning alternative will depend upon many variables, some of which may not be accounted for or fully described in this presentation. Unless otherwise indicated, the income tax and generation-skipping transfer (GST) tax implications of particular transactions are not reflected in the analysis.

Representation of the tax law in this illustration are based on the law existing at the time of publication. John Hancock makes no representation as to future federal or state tax law.

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**CROSS PURCHASE BUY-SELL ARRANGEMENTS**

**THE PROBLEM**

Many business owners do not make formal plans to transfer the business in the event of the premature death or disability of a business owner, the lifetime transfer or sale of the business, or the retirement of one of the key business owners. Lack of planning can cause a business to fail because of the significant changes that are brought about due to these triggering events. Although in some cases a buy-sell arrangement is in place dictating how the business is to transfer, often these arrangements remain unfunded.

**THE SOLUTION**

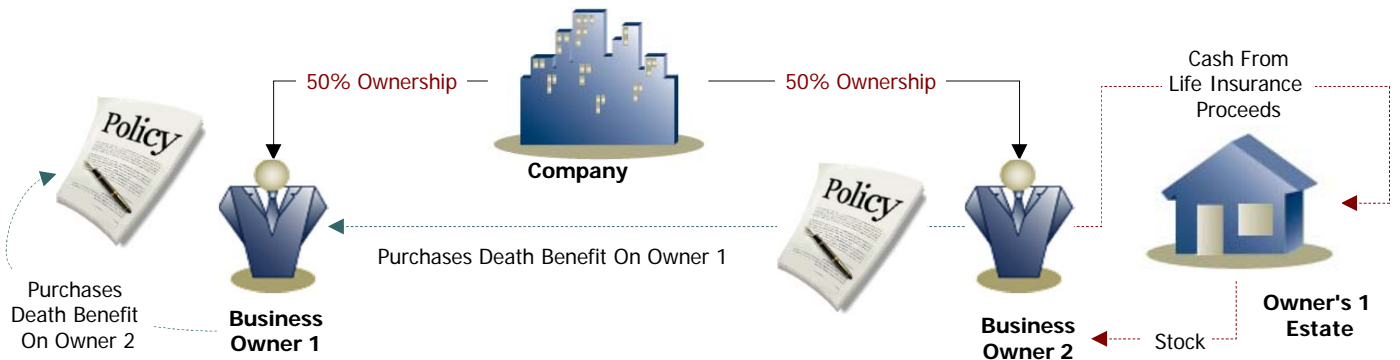
A well drafted and properly funded cross purchase buy-sell arrangement can be established in which the owners of a company agree to buy each other's business interest in the event of death, disability, retirement or other termination event. The buy-sell plan provides clarification as to who will run the business after your death or the death of one of the other owners. The arrangement can be funded with a permanent life insurance policy on each owner to help ensure that the company has the liquidity necessary to transition the business according to a prearranged plan. A permanent life insurance policy provides the flexibility needed to accommodate changing needs over the life span of the business<sup>1</sup>.

**HOW IT WORKS**

You and each of your business partners purchase and own a permanent life insurance policy on the lives of each other. You may pay premiums out of personal funds or the corporation may pay bonuses to each of you in the amount of the premium payments annually to minimize the out-of-pocket expense of the plan to each owner. The bonus payments may be tax-deductible to the corporation when paid but the payment made to each owner will be taxable<sup>2</sup>. In some cases the corporation may choose to make a double bonus in which the bonus is equivalent to the premiums due plus the tax you must pay on the bonus.

Upon the death of each shareholder, each of the remaining shareholders will use the proceeds of the policy that they own on the life of the deceased shareholder to carry out their obligation to purchase a pro-rata share of the deceased shareholder's stock. This type of arrangement works particularly well for pass-through entities such as S Corporations, partnerships and Limited Liability Companies (LLCs).

It is necessary to establish the value of the business in order to ascertain the value of each life insurance policy that will be used to fund the buy-sell agreement. Fixing the value of the business can eliminate future disagreements and avoid confusion and additional expenses. The valuation may also be relied upon for estate tax purposes to provide a fixed value for both a lifetime transfer of the business as well as the transfer of the business at death<sup>3</sup>. There are a number



1 A cross purchase buy-sell plan funded with life insurance works best when there are three or fewer owners of the business given the multiple life insurance policies required.  
2 The use of a bonus arrangement creates additional compensation to you and must fall within the reasonable compensation guidelines of the Internal Revenue Code Section 162 in order to be deductible by the corporation.

3 IRC §2703 provides certain tests the taxpayer must meet to permit the value of the buy-sell agreement to set the value for federal estate tax purpose. First, the buy-sell agreement must reflect a bona fide business arrangement. Second, the buy-sell agreement must not represent a device to transfer the business interest to the decedent's family or the natural objects of the decedent's bounty for less than full and adequate consideration. Third, the terms of the buy-sell agreement must remain comparable to similar arrangements entered into by persons in arms-length transactions.

## CROSS PURCHASE BUY-SELL ARRANGEMENTS

of valuation methods that can be used including a multiple of book value, qualified business appraisal, or capitalization of earnings method<sup>4</sup>. Therefore, it is important for you to first determine the value of your business with the help of your professional advisors.

Funding a cross purchase plan typically requires multiple life insurance policies. The number of policies can be determined by the formula  $x=n(n-1)$ , where "x" is the number of policies needed and "n" is the number of owners. For example, if there are three owners, the number of policies required is six (3x2).

The permanent life insurance policy can be cost effective and can be sufficiently flexible to supply liquidity to facilitate the buy-out when needed. Although the primary use of the insurance policy is to fund the purchase of the business interest on the owner's death the policy cash value may be available for a triggering event during life.

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 59½. Cash value available for loans and withdrawals may be more or less than originally invested. Withdrawals are available in the 2nd policy year.

## BENEFITS

- The life insurance proceeds should not be subject to income taxes<sup>5</sup>.
- Life insurance used to fund a cross purchase agreement does not increase the value of the business because the company is not required to reflect the value of the policy on its balance sheet.
- The life insurance proceeds used to fund the cross purchase obligation are not treated as dividend distributions.
- Since the business is not a party to the cross purchase agreement, the alternative minimum tax (AMT) and accumulated earnings tax do not apply to the policy proceeds.
- The value of the business may be fixed for estate tax purposes.
- The surviving owners receive a "step-up" in basis in the purchased shares. This tax basis increase is a primary advantage of the Cross-Purchase plan

## CONSIDERATIONS

- The plan may require several life insurance policies and may be cumbersome to administer if there are more than four owners.
- If you or one of the other owners has difficulty making premium payments, the cross purchase plan may not be fully funded at any given time.
- The life insurance premium payments are not tax-deductible.
- Since a cross purchase plan involves more than one owner, the surviving owners must consider the transfer-for-value rule. This rule may subject the life insurance proceeds to income tax to the extent the proceeds exceed the purchase price and any subsequent premiums paid. Through proper planning, the transfer-for-value rule can be avoided<sup>6</sup>.
- Representation of the tax law in this illustration are based on the law existing at the time of publication.
- The value that is fixed in the buy-sell agreement may change by the time of a triggering event such as death, although the valuation method may remain the same. If the value of the business decreases by the time of a triggering event, then the remaining owners may not need to use all of the life insurance funding for the buy-sell arrangement.
- If you are considering creating a policy with a long-term care rider where the owner is not the insured, there may be adverse consequences - both tax and contractual in nature. You should review the particulars of your intended ownership arrangement with your legal and tax counsels in light of the income, gift, and estate tax provisions of the Internal Revenue Code

## PLANNING OPTIONS

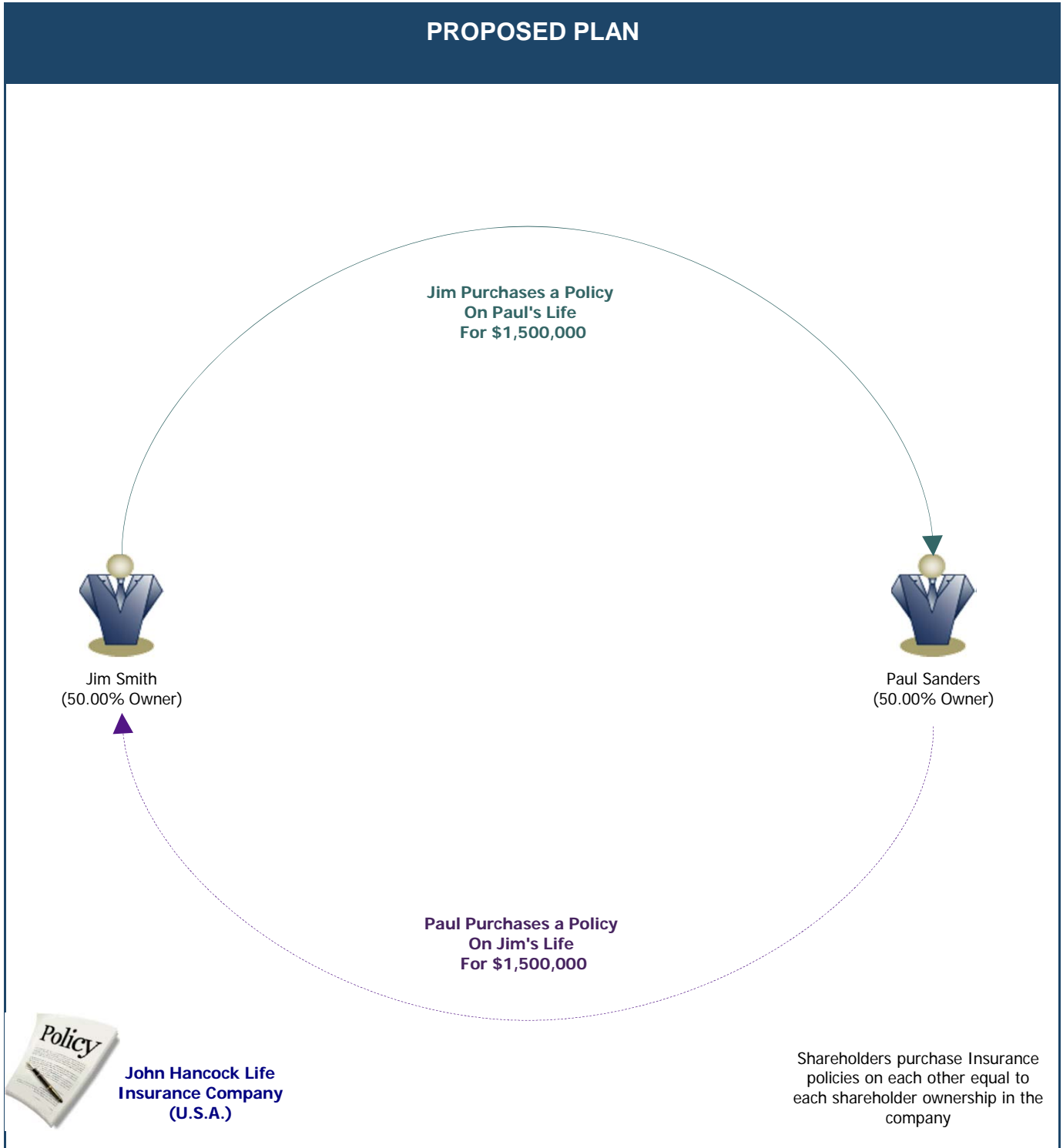
The following flowcharts and ledger pages illustrate the plan mechanics, and the costs and benefits of the cross purchase buy-sell plan to the business and each business owner.

<sup>4</sup> Generally, the business should obtain an independent audit of its books and financial records prior to use of the book value method.

<sup>5</sup> See IRC §101(a)(1) and Regulation Section 1.101-1(a)(1)

<sup>6</sup> See IRC §101(a)(2). See PLR 200747002 for an example of a Limited Liability Company (LLC) to fund a Buy-Sell Agreement. A PLR is merely an IRS interpretation of law and is only binding upon the taxpayer to whom it is issued. Please consult your tax advisors.

CROSS PURCHASE BUY-SELL ARRANGEMENTS



This is a supplemental illustration authorized for distribution only when preceded or accompanied by a basic illustration from the issuer. Benefits and values may not be guaranteed; the assumptions on which they are based are subject to change by the insurer. Actual results may be more or less favorable. Refer to the basic illustration for guaranteed elements and other important information. Clients should consult their accounting, legal, and tax advisors about their particular circumstances before implementing any recommendations. See attached Glossary of Ledger Terms

**CROSS PURCHASE BUY-SELL ARRANGEMENTS**

**COMPANY INFORMATION**

Company Name..... Company

Fair Market Value..... \$3,000,000

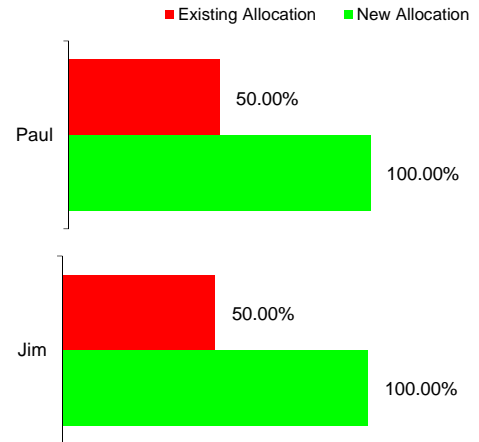
Growth Rate..... 0.00%

**INSURANCE SUMMARY**

Shareholder Name	Age	Sex	Risk Class	Ownership In Company	Ownership Amount	Initial Premium	Initial Face Amount
<b>1. Jim Smith</b>							
	47	Male	Preferred NonSmoker	50.00%	\$1,500,000		
Paul Sanders						9,578	1,500,000
<b>2. Paul Sanders</b>							
	49	Male	Preferred NonSmoker	50.00%	\$1,500,000		
Jim Smith						10,580	1,500,000
				<b>Totals</b>	<b>100.00%</b>	<b>20,158</b>	<b>3,000,000</b>

**BREAKDOWN OF LIFE INSURANCE**

	<u>New Allocation</u>	<u>Death Benefit Received</u>
<b>1. If Jim Smith Dies</b>		
Paul Sanders	100.00%	\$1,500,000
	<hr/>	
	100.00%	\$1,500,000
<b>2. If Paul Sanders Dies</b>		
Jim Smith	100.00%	\$1,500,000
	<hr/>	
	100.00%	\$1,500,000



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Cross Purchase Plan For Policies Purchased By Jim Smith

**PAUL SANDERS**

John Hancock's Protection UL 15 with Initial Death Benefit of \$1,500,000  
& Initial Premium of \$10,580

Yr	Att. Age	Annual Premium	Annual Withdrawals and/or Loans	Net Surrender Value	Total Net Death Benefit	Total Cost to Jim Smith (50.00% Owner)
1	48	10,580	0	0	1,500,000	10,580
2	49	10,580	0	0	1,500,000	10,580
3	50	10,580	0	0	1,500,000	10,580
4	51	10,580	0	1,364	1,500,000	10,580
5	52	10,580	0	6,223	1,500,000	10,580
6	53	10,580	0	11,178	1,500,000	10,580
7	54	10,580	0	18,747	1,500,000	10,580
8	55	10,580	0	26,502	1,500,000	10,580
9	56	10,580	0	34,370	1,500,000	10,580
10	57	10,580	0	42,390	1,500,000	10,580
11	58	10,580	0	47,273	1,500,000	10,580
12	59	10,580	0	52,291	1,500,000	10,580
13	60	10,580	0	57,409	1,500,000	10,580
14	61	10,580	0	62,606	1,500,000	10,580
15	62	10,580	0	67,850	1,500,000	10,580
16	63	10,580	0	73,050	1,500,000	10,580
17	64	10,580	0	78,205	1,500,000	10,580
18	65	10,580	0	83,250	1,500,000	10,580
19	66	10,580	0	88,099	1,500,000	10,580
<b>20</b>	<b>67</b>	<b>10,580</b>	<b>0</b>	<b>96,030</b>	<b>1,500,000</b>	<b>10,580</b>
21	68	10,580	0	105,943	1,500,000	10,580
22	69	10,580	0	116,352	1,500,000	10,580
23	70	10,580	0	127,237	1,500,000	10,580
24	71	10,580	0	138,571	1,500,000	10,580
25	72	10,580	0	150,326	1,500,000	10,580
26	73	10,580	0	162,473	1,500,000	10,580
27	74	10,580	0	175,010	1,500,000	10,580
28	75	10,580	0	187,891	1,500,000	10,580
29	76	10,580	0	201,077	1,500,000	10,580
30	77	10,580	0	214,543	1,500,000	10,580
31	78	10,580	0	228,087	1,500,000	10,580
32	79	10,580	0	241,832	1,500,000	10,580
33	80	10,580	0	255,602	1,500,000	10,580
34	81	10,580	0	269,343	1,500,000	10,580
35	82	10,580	0	282,991	1,500,000	10,580
36	83	10,580	0	296,498	1,500,000	10,580
37	84	10,580	0	309,751	1,500,000	10,580
38	85	10,580	0	322,687	1,500,000	10,580
39	86	10,580	0	335,226	1,500,000	10,580
40	87	10,580	0	347,269	1,500,000	10,580
Totals:		423,200	0			423,200

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Cross Purchase Plan For Policies Purchased By Jim Smith

**PAUL SANDERS**

John Hancock's Protection UL 15 with Initial Death Benefit of \$1,500,000  
& Initial Premium of \$10,580

Yr	Att. Age	Annual Premium	Annual Withdrawals and/or Loans	Net Surrender Value	Total Net Death Benefit	Total Cost to Jim Smith (50.00% Owner)
41	88	10,580	0	358,780	1,500,000	10,580
42	89	10,580	0	369,717	1,500,000	10,580
43	90	10,580	0	379,981	1,500,000	10,580
44	91	10,580	0	389,505	1,500,000	10,580
45	92	10,580	0	398,161	1,500,000	10,580
46	93	10,580	0	405,932	1,500,000	10,580
47	94	10,580	0	413,003	1,500,000	10,580
48	95	10,580	0	419,531	1,500,000	10,580
49	96	10,580	0	425,636	1,500,000	10,580
50	97	10,580	0	431,259	1,500,000	10,580
51	98	10,580	0	436,345	1,500,000	10,580
52	99	10,580	0	440,936	1,500,000	10,580
53	100	10,580	0	444,980	1,500,000	10,580
54	101	10,580	0	448,554	1,500,000	10,580
55	102	10,580	0	451,802	1,500,000	10,580
56	103	10,580	0	454,913	1,500,000	10,580
57	104	10,580	0	458,087	1,500,000	10,580
58	105	10,580	0	461,413	1,500,000	10,580
59	106	10,580	0	465,311	1,500,000	10,580
60	107	10,580	0	470,576	1,500,000	10,580
61	108	0	0	471,511	1,500,000	0
62	109	0	0	472,242	1,500,000	0
63	110	0	0	472,935	1,500,000	0
64	111	0	0	473,537	1,500,000	0
65	112	0	0	473,955	1,500,000	0
66	113	0	0	474,037	1,500,000	0
67	114	0	0	473,525	1,500,000	0
68	115	0	0	471,991	1,500,000	0
69	116	0	0	468,717	1,500,000	0
70	117	0	0	445,666	1,500,000	0
71	118	0	0	368,744	1,500,000	0
72	119	0	0	267,714	1,500,000	0
73	120	0	0	0	0	0
74	121	0	0	0	0	0

Totals: 634,800 0 634,800

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Cross Purchase Plan For Policies Purchased By Paul Sanders

**JIM SMITH**

John Hancock's Protection UL 15 with Initial Death Benefit of \$1,500,000  
& Initial Premium of \$9,578

Yr	Att. Age	Annual Premium	Annual Withdrawals and/or Loans	Net Surrender Value	Total Net Death Benefit	Total Cost to Paul Sanders (50.00% Owner)
1	50	9,578	0	0	1,500,000	9,578
2	51	9,578	0	0	1,500,000	9,578
3	52	9,578	0	0	1,500,000	9,578
4	53	9,578	0	1,002	1,500,000	9,578
5	54	9,578	0	5,395	1,500,000	9,578
6	55	9,578	0	9,890	1,500,000	9,578
7	56	9,578	0	16,788	1,500,000	9,578
8	57	9,578	0	23,879	1,500,000	9,578
9	58	9,578	0	31,097	1,500,000	9,578
10	59	9,578	0	38,482	1,500,000	9,578
11	60	9,578	0	43,034	1,500,000	9,578
12	61	9,578	0	47,748	1,500,000	9,578
13	62	9,578	0	52,609	1,500,000	9,578
14	63	9,578	0	57,598	1,500,000	9,578
15	64	9,578	0	62,679	1,500,000	9,578
16	65	9,578	0	67,800	1,500,000	9,578
17	66	9,578	0	72,951	1,500,000	9,578
18	67	9,578	0	78,085	1,500,000	9,578
19	68	9,578	0	83,140	1,500,000	9,578
<b>20</b>	<b>69</b>	<b>9,578</b>	<b>0</b>	<b>88,034</b>	<b>1,500,000</b>	<b>9,578</b>
21	70	9,578	0	92,630	1,500,000	9,578
22	71	9,578	0	101,852	1,500,000	9,578
23	72	9,578	0	111,740	1,500,000	9,578
24	73	9,578	0	122,094	1,500,000	9,578
25	74	9,578	0	132,889	1,500,000	9,578
26	75	9,578	0	144,092	1,500,000	9,578
27	76	9,578	0	155,700	1,500,000	9,578
28	77	9,578	0	167,691	1,500,000	9,578
29	78	9,578	0	180,043	1,500,000	9,578
30	79	9,578	0	192,712	1,500,000	9,578
31	80	9,578	0	205,543	1,500,000	9,578
32	81	9,578	0	218,652	1,500,000	9,578
33	82	9,578	0	231,988	1,500,000	9,578
34	83	9,578	0	245,519	1,500,000	9,578
35	84	9,578	0	259,070	1,500,000	9,578
36	85	9,578	0	272,591	1,500,000	9,578
37	86	9,578	0	286,020	1,500,000	9,578
38	87	9,578	0	299,309	1,500,000	9,578
39	88	9,578	0	312,344	1,500,000	9,578
40	89	9,578	0	325,061	1,500,000	9,578
Totals:		383,120	0			383,120

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Cross Purchase Plan For Policies Purchased By Paul Sanders

**JIM SMITH**

John Hancock's Protection UL 15 with Initial Death Benefit of \$1,500,000  
& Initial Premium of \$9,578

Yr	Att. Age	Annual Premium	Annual Withdrawals and/or Loans	Net Surrender Value	Total Net Death Benefit	Total Cost to Paul Sanders (50.00% Owner)
41	89	9,578	0	337,445	1,500,000	9,578
42	90	9,578	0	349,406	1,500,000	9,578
43	91	9,578	0	360,855	1,500,000	9,578
44	92	9,578	0	371,754	1,500,000	9,578
45	93	9,578	0	381,945	1,500,000	9,578
46	94	9,578	0	391,356	1,500,000	9,578
47	95	9,578	0	399,915	1,500,000	9,578
48	96	9,578	0	407,610	1,500,000	9,578
49	97	9,578	0	414,627	1,500,000	9,578
50	98	9,578	0	421,120	1,500,000	9,578
51	99	9,578	0	427,213	1,500,000	9,578
52	100	9,578	0	432,853	1,500,000	9,578
53	101	9,578	0	437,992	1,500,000	9,578
54	102	9,578	0	442,691	1,500,000	9,578
55	103	9,578	0	446,925	1,500,000	9,578
56	104	9,578	0	450,817	1,500,000	9,578
57	105	9,578	0	454,586	1,500,000	9,578
58	106	9,578	0	458,544	1,500,000	9,578
59	107	9,578	0	463,097	1,500,000	9,578
60	108	9,578	0	468,681	1,500,000	9,578
61	109	0	0	470,301	1,500,000	0
62	110	0	0	471,937	1,500,000	0
63	111	0	0	473,728	1,500,000	0
64	112	0	0	475,894	1,500,000	0
65	113	0	0	478,965	1,500,000	0
66	114	0	0	483,505	1,500,000	0
67	115	0	0	490,453	1,500,000	0
68	116	0	0	501,366	1,500,000	0
69	117	0	0	518,831	1,500,000	0
70	118	0	0	547,158	1,500,000	0
71	119	0	0	593,527	1,500,000	0
72	120	0	0	638,034	1,500,000	0

Totals: 574,680 0 574,680

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**Cross Purchase Buy-Sell Arrangements**

**ASSUMPTIONS**

	Value	Explanation
<b>PLAN INFORMATION</b>		
Company Name	Company	Names of the heirs
Company's Fair Market Value	\$3,000,000	
Company's Growth Rate	0.00%	
Company's Tax Bracket	35.00% from 1 to Lifetime	Corporations Tax Rate
<b>Buy-Sell Arrangement</b>	Cross Purchase	
<b>Focus Year *</b>	20	Focus Year
<b>PRESENTER INFORMATION</b>		
Presenter's Name	Advanced Markets	Name of presenter
Agency Name	John Hancock	
Address	197 Clarendon St.	
City State, ZIP	Boston, MA 02116	
Telephone	888-266-7498, Option #3	
Fax	617-572-6595	
E-Mail Address	AdvancedMarkets@Jhancock.com	

\* The focus year refers to the year that has been chosen by you. The values in the focus year are highlighted, can be changed and are for your convenience only. The year may be life expectancy, a random year, or a year that coincides with your personal planning goals.

## CROSS PURCHASE BUY-SELL ARRANGEMENTS - CENSUS

### PARTICIPANT INFORMATION

Participant	1	2		
Mode	Active	Active		
Owner Name	Jim Smith	Paul Sanders		
Age	47	49		
Sex	Male	Male		
Risk Class	Preferred NonSmoker	Preferred NonSmoker		
Company Ownership	50.00%	50.00%		
State	0	Michigan		
Income Tax	35.00%	35.00%		
Vitality Status	Gold	Gold		

### LIFE INSURANCE

Policy Name	Protection UL 15	Protection UL 15		
Type	Single Life	Single Life		
Initial Death Benefit	\$1,500,000	\$1,500,000		
Annualized Premium	\$9,578	\$10,580		
Premium Years	99	99		
Policy Rate	5.05% Gross	5.05% Gross		
1035 Exchange Amount	\$0	\$0		
<b>BENEFICIARY</b>	<b>Paul Sanders</b>	<b>Jim Smith</b>		
Life Track Billing	FALSE	FALSE		

This is a supplemental illustration authorized for distribution only when preceded or accompanied by a basic illustration from the issuer. Benefits and values may not be guaranteed; the assumptions on which they are based are subject to change by the insurer. Actual results may be more or less favorable. Refer to the basic illustration for guaranteed elements and other important information. Clients should consult their accounting, legal, and tax advisors about their particular circumstances before implementing any recommendations.

## GLOSSARY OF LEDGER TERMS - CROSS ENDORSEMENT BUY-SELL PLAN

**Cross-Purchase Buy-Sell Arrangement** – This is a type of buy-sell arrangement in which each shareholder owns a life insurance policy on the life of each of the other shareholders. Upon the death of each shareholder, each of the remaining shareholders will use the proceeds of the policy that they own on the life of the deceased shareholder to carry out their obligation to purchase a pro-rata share of the deceased shareholder's stock. This type of arrangement works particularly well for pass-through entities such as S Corporations, partnerships and Limited Liability Companies (LLCs).

**Census Summary** – The Census Summary is a listing of each of the owners of the company, their ages and risk class as well as each owner's current ownership percentage in the company

**Annualized Premium** – This row under the Census Summary shows the premium required on each business owner's policy based on the total death benefit purchased.

**Initial Death Benefit** – This row under the Census Summary shows the amount of the death benefit that each individual owner owns on the other shareholders. The death benefit may be either equal to the insured's ownership percentage or a portion of the insured's ownership percentage, depending on the total number of business owners.