

Advisors working in the business market have long been caught between a rock and a hard place when working on Buy/Sell Agreement funding. The appeal of a Stock Redemption Plan from an ease of administration perspective is a powerful incentive to look to these structures. There are, however, some unintended consequences for surviving owners as well as the disposition of life policies at retirement of the business owner.

These unintended consequences include things like sub-optimal tax management for surviving owners upon sale of the business as well as navigating the complicated transfer for value rules when seeking to allow retiring owners to gain control of the insurance policy for personal planning needs.

By utilizing a Manager Managed LLC (MMLLC) to own the policies that fund the Buy-Sell agreement, the tax issues involved with a Stock Redemption Plan can be avoided, as can the administrative headaches of a Cross Purchase Plan involving more than two owners. While not as simple as the Stock Redemption Plan, the potential upside for the surviving owners is more than worth the investment of time and the cost of a bit of legal work at plan inception.

10 Benefits of a Manager Managed LLC

1. An MMLLC reduces the number of insurance contracts needed for Cross-Purchase Buy-Sell arrangements. As an example, four owners require only four policies with an MMLLC, compared to twelve in a traditional plan.
2. Common policy ownership simplifies premium payments as fewer policies are involved.
3. MMLLC ownership ensures all policies stay in force, preventing an owner from dropping coverage, providing stability in funding the Buy-Sell arrangement.
4. MMLLC control streamlines policy administration and ensures death benefits are used for purchasing the decedent's interest according to the Buy-Sell agreement.
5. Upon an owner's death, the MMLLC maintains control, ensuring the remaining policies' benefits are available for the Buy-Sell arrangement.
6. If the death benefits aren't needed (e.g., the business is sold), the MMLLC can distribute policies to owners for personal wealth management, which wouldn't happen without unified ownership.
7. MMLLC ownership protects the policies' value, especially in cases where a policy becomes more valuable, such as due to health decline, preventing reluctance to transfer ownership.
8. Policy exchanges between owners are taxable events and don't qualify for tax-free IRC 1035 exchanges, making unified ownership under the MMLLC more beneficial.
9. In traditional arrangements, policies held by a deceased owner are included in their estate for tax purposes, but MMLLC ownership avoids this.
10. Policy transfers to the MMLLC and their distribution upon MMLLC termination are exempt from transfer-for-value rules under Section 101 of the Internal Revenue Code

The MMLLC approach is a particularly interesting strategy in the light of the recent Connelly Supreme Court decision. The fundamental issue raised by the Court regarding inclusion of life insurance proceeds in business valuations without a considering the purchase obligation under a Stock Redemption Plan as an offsetting liability has many businesses reevaluating their agreements. That process will also undoubtedly uncover inadequately funded plans, potential other issues with ownership or beneficiary designations and more. While not the only potential remedy, business with a higher number of owners stand to see the most benefit from moving to a MMLLC for their Buy/Sell Agreement funding strategy. Please see the following page for a summary of MMLLC mechanics.

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Buy-Sell Strategy: Flexibility Without Administrative Headaches!

Balancing convenience with long-term flexibility and efficiency in buy-sell planning boils down to one key question: How can we enhance planning flexibility and tax efficiency without increasing administrative complexity or risk? In buy-sell agreements, this becomes even more critical as ownership transitions must be smooth, well-funded, and tax-optimized.

Manager Managed LLC Basics

- The MMLLC is structured to ensure that the Members are not deemed to have any retained incidents of ownership in the policies, which would cause estate tax inclusion of death benefits upon a Member's death. The MMLLC strictly prohibits the Members from serving as Managers and further disallows the exercise of any right or power by any of the Members with regard to insurance contracts insuring their lives.
- Each Member is required to make capital contributions so that the MMLLC can make premium payments on the insurance contracts. Capital contributions made by a Member are credited to that Member's Capital Account.
- Capital contributions do not have to be equal between the Members. The contribution amount required from each Member may be determined by the amount of death benefit required by each Member to satisfy their purchase obligations under the Buy-Sell agreement.
- The Members' underlying operating business can make these capital contributions payments directly to the MMLLC and allocate the contributions to each business owner as income as the business owners themselves determine.
- The MMLLC will not have any income tax liability if all contributions are used to make premium payments on the contracts because any income earned inside the contracts is non-taxable.
- The MMLLC may own other assets. It is not restricted to ownership of just life insurance policies.
- Upon the death of a Member, the death benefit paid from the contract insuring that Member's life is allocated to the Capital Accounts of the surviving Members in the proportions necessary to allow each Member to fulfill his/her purchase obligation under the terms of the Buy-Sell agreement.
- The MMLLC provides asset protection planning benefits, as a creditor of one of the Members cannot get at the assets of the MMLLC. Policies owned directly by the business owners on the lives of one another are probably not protected from creditors' claims. This means that creditors in a judicial proceeding can attach those policies.

For those seeking greater clarity on the Connelly Decision or additional details regarding the tax planning challenges of Stock Redemption Agreements and potential solutions, please reach out to the office for a copy of our Guide to Manager Managed LLCs and other resources.

Additional Resources: [Buy-Sell Planning Guide](#)

READY TO PUT US TO WORK ON YOUR NEXT CASE?