

Wait-and-See Agreements

Buy/Sell Planning Using Life Insurance

Consumer Overview

Wait-and-See Purchase Agreement Funded by Life Insurance

The decision as to whether a cross purchase buy/sell arrangement or a stock redemption plan is better may be difficult to determine at the time the plan is adopted. A wait-and-see agreement lets the business owners wait until the first death or other triggering event occurs to decide whether the business or the owners should purchase the business interest. This flexibility is useful because the best results often cannot be determined until a triggering event actually occurs. The wait-and-see agreement allows the purchaser to be the entity, the owners, or both.

With the typical wait-and-see plan, the business has the first option to purchase the stock at the price or formula set in the agreement. If the business fails to exercise its option, the surviving business owners have a second option to purchase the stock. Finally, if the business owners fail to purchase the stock, or only purchase a portion of it, then the entity is required to purchase the remainder.

A wait-and-see arrangement adds flexibility because if a cross purchase plan is more advantageous than a stock redemption, the business will not exercise its first option to buy the stock. On the other hand, if a stock redemption plan would be the most advantageous, and the insurance policies are owned by and payable to the shareholders, the surviving shareholders may decide to lend the proceeds to the entity after a death occurs. When the entity pays back the loan, it will not be considered income to the owners, except for any interest that is paid on the loan.

Generally, the funding for a wait-and-see agreement should be at the owner level because:

1. If the agreement is funded at the entity level, all the potential problems of an entity purchase agreement apply.
2. If the life insurance is cross-owned, the owners will receive basis credit for their purchase of the interest or they could make a capital contribution to the entity and receive a basis step-up for the capital contribution.

Advantages

- Flexibility - This is the most flexible type of buy/sell agreement because the purchase can be done at either the entity or owner level. The choice is made at the time of the triggering event, rather than on the date on which the agreement was signed.

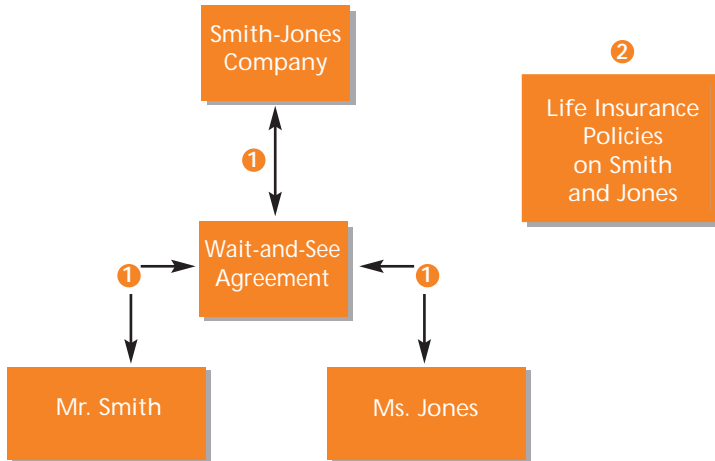
Disadvantages

- Life insurance and multiple owners - If the funding is at the owner level and there are multiple owners, the administrative complexity of each owner owning a policy on every other owner is the same as with a cross purchase agreement.
- Inequality of total benefits received - Depending on the timing of a triggering event, the total benefits received by each shareholder may not be equal (see the "No-Sell Buy/Sell Planning Agreements" - form 117675).

The chart on the following page depicts a wait-and-see agreement.

Here's how it works.

Establishing & Funding the Plan



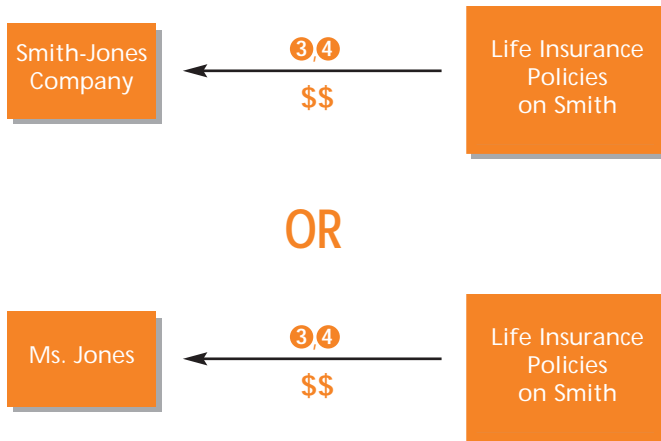
1. The Smith-Jones Co. establishes a wait-and-see purchase agreement with Mr. Smith and Ms. Jones.
2. Funding can be at the entity level (Smith-Jones Co. buys life insurance on Mr. Smith and Ms. Jones)

OR

Funding can be at the individual level (Mr. Smith and Ms. Jones buy life insurance policies on each other.)

3. Assuming Mr. Smith dies, his interest passes to his family or his estate.
4. Depending on whether the corporation or the individual owners purchased the life insurance policies, they are paid the proceeds from Mr. Smith's policy.
5. First, Smith-Jones Co. may exercise its option to purchase any or all of the decedent's (Mr. Smith's) interest.

At Death or Other Triggering Event



6. If the Smith-Jones Co. does not buy all of the deceased owner's interest, the surviving shareholder(s) has the option to purchase it.
7. The Smith-Jones Co. must then redeem any remaining shares. Any entity redemption is usually funded with capital contributed by the surviving shareholders from the insurance proceeds.

Result

Either the business or surviving owner purchase the business interest from the deceased owner's estate, depending on which is most advantageous to the Smith-Jones Co. and the surviving owner.

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