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

**Corporate Section 303 Stock Redemption Agreement**

This sample agreement has been prepared as a guide to assist attorneys. Our publication, *Insurance-Related Best Practices Guide for Buy-Sell Agreements* (BB11258), discusses some of the pertinent issues to consider in drafting such agreements. **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 review the agreements for the client’s particular circumstances. The client’s attorney is ultimately responsible for creation of the agreements necessary to implement the arrangement. The use of this agreement does not create an attorney-client relationship between the client and Principal Financial Group or any Principal employee.

**Forward to Counsel – Internal Revenue Code Section 303 Redemption of Stock applicable to Family Corporations**

**Brief summary of background tax information**

Depending upon a number of factors, the redemption of stock by a family C corporation (or S corporation that was formerly a C corporation) from the estate of a shareholder at death may be considered a corporate dividend or a capital transaction. Preferred tax treatment will virtually always be to have the redemption be considered a capital transaction (and not a dividend). This is because in a capital transaction, the proceeds paid to the estate will generally be received income tax free, because of the step-up in basis at death for capital property, but if the redemption is treated as a dividend, there may be taxation up to earnings and profits (generally referred to as retained earnings) in the corporation.

If a redemption of stock at the death of a shareholder as a capital transaction is not otherwise possible (based on tax rules generally found in IRC Section 302, including attribution rules found in IRC Section 318 applicable to IRC Section 302), a means by which the corporation may redeem at least some stock as a capital transaction is found in IRC Section 303. However, there are qualification requirements.

**Qualifying redemptions amounts**

The amount of qualified stock being redeemed to receive capital transaction treatment under IRC Section 303 may not exceed death taxes (state and federal) and funeral and administration expenses applicable to the estate of the deceased shareholder.

**Qualifying estates**

To be eligible for Section 303 treatment, the value of the decedent’s stock included in the gross estate must generally exceed 35% of the value of the adjusted gross estate. If the decedent owns stock in two or more corporations, then for purposes of reaching the 35% threshold, the value of the different stocks may be aggregated as long as the estate holds at least a 20% interest in each corporation.

**Qualifying time frame**

In general, to be eligible for Section 303 treatment, the redemption must take place after the shareholder’s death, but no later than three years and three months from the due date of the federal estate tax return.

**Purpose of the sample agreement**

The agreement is designed to give the executor of the estate of a deceased shareholder of a family-owned business the option to sell estate stock to the corporation in an amount not to exceed IRC Section 303 limitations. The agreement includes provisions to determine the redemption price. The agreement also requires the corporation to purchase life insurance on the shareholder as listed in Schedule A. No other buy-sell triggers are included in the sample agreement.

**General use of sample agreement**

The agreement might be used in situations where a family business is being left at the death of the business owner to family members through the last will and testament of the business owner (or through a revocable trust) and is not otherwise subject to a buy-sell agreement. For the Section 303 redemption amount to be meaningful, there would generally also need to be a substantial federal estate tax and/or state death tax due at the death of the business owner.

Under this agreement, insurance funding should be structured with the Company as premium payer (paying the premium as a non-deductible expense), owner, and beneficiary of life insurance coverage on the shareholders. 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 Shareholder’s interest in the Corporation.

IRC Section 101(j) notice and consent compliance is necessary to preserve the tax-free death benefit afforded by IRC Section 101(a) for life insurance death proceeds received by the Corporation. Our business-owner application packet contains the necessary form.

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

**Corporate Section 303 Stock Redemption Agreement**

This Agreement, entered into this \_\_\_\_\_\_\_\_\_\_ day of \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, 20\_\_\_\_, by and between
 (Name) , of (Address) , and (Name) , of (Address) , hereafter called "Primary Shareholder," [other Shareholders,] and (Name) , a (State [Commonwealth]) , corporation with principal offices at (Address) , hereafter called the "Corporation."

***Note to Counsel****: The sample agreement assumes only one Primary Shareholder but could be modified to include additional Primary Shareholder(s).*

**Witnesseth:**

**Whereas**, the Primary Shareholder owns the following number of shares of stock in the Corporation:

 (Name) , Shares

**Whereas**, the Primary Shareholder wishes to make all of said stock and any stock acquired hereafter, subject to the terms of this Agreement;

**Whereas**, the Corporation, Primary Shareholder, and other Shareholders, for their mutual protection and the more harmonious and successful management of the Corporation, wish to provide for the possible purchase and sale of the Primary Shareholder's stock upon his/her death; and

**Whereas**, it is the intent of the Corporation, Primary Shareholder, and other Shareholders to secure this Agreement by the use of life insurance to provide all or a substantial part of the purchase price when needed to carry out this Agreement upon the death of the Primary Shareholder.

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

1. **Purchase of decedent’s stock.** Upon the death of the Primary Shareholder, his/her legal representative shall have the right to sell all or as much of the decedent's stock in the Corporation as he/she may be empowered to sell; however, in no event shall the Corporation be required to redeem stock that has been included in determining the Primary Shareholder’s gross estate in excess of that amount which can be treated as a distribution for purposes of Section 303 of the Internal Revenue Code of 1986 as amended. The Corporation shall, within \_\_\_\_\_\_ days after receiving written notice from said legal representative designating the number of shares he/she wishes to have redeemed, proceed to redeem said shares for the value determined in Article No. 2. If said legal representative has not tendered the decedent's stock to the Corporation for redemption, as herein specified, within \_\_\_\_\_ months after the Shareholder's death, then this Agreement shall terminate. It is the intent of the parties hereto that the proceeds of the life insurance policy(s) appertaining to this Agreement shall be used for purposes of the redemption.

In the event the proceeds of the life insurance so carried on the Shareholder's life are not sufficient for purposes of the redemption, the Corporation shall pay the balance in one sum.

In the event the value of the stock, which is offered for redemption is less than the proceeds of the life insurance so carried on the Primary Shareholder’s life, the balance shall be retained by the Corporation for its own benefit.

*[It is recommended that the Primary Shareholder’s last will and testament specifically empower his/her legal representative to dispose of the stock to the extent desired and in an amount which is consistent with this Agreement.]*

1. **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**

The Shareholders (including the Primary Shareholder) agree at the time of execution of this contract unanimously agree that the overall fair market value (“Agreed Value”) for purposes of this Agreement and as of this date, is as indicated on Schedule B, attached to this Agreement.

Each year as part of the Corporation’s annual meeting, the Shareholders (including the Primary Shareholder) 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. Each annual Agreed Value shall be posted to Schedule B of this Agreement as it is approved.

If the Agreed Value has not been updated within [12 months] [18 months] [24 months] of the buy-sell trigger, then an appraisal process shall be used to establish fair market value. The Corporation and the legal representative of the deceased Primary Shareholder 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 primary shareholder’s death, 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 averaging, without weighting, all three appraised values.

In any determination of value made after the death of the Primary 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 parties 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 legal representative of the deceased Primary Shareholder 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 averaging, without weighting, all three appraised values.

In any determination of value made after the death of the Primary 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 parties 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 a business owner appears likely to have a substantial estate tax liability at death, then best practice suggests that the buy-sell agreement be utilized to “lock-in” the buy-sell agreement’s method of establishing the value of the company for estate tax valuation purposes.* ***“Locking in” a value of stock for federal estate tax purposes may require modification of this sample agreement.*** *The IRS requirements for a buy-sell agreement 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 or her interest during life without first offering it to the other party or parties at no more than the agreement price;
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; and
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 similararrangements entered into by persons in an arms-length transaction. Although a 303 stock redemption is not directly between family members, this type of arrangement is generally designed to benefit family members participating in the business. As a result, IRC Section 2703 may apply. [Paragraph E is not applicable to buy-sell agreements entered into prior to October 9, 1990, and not substantially modified after such date.]
6. **Transfer of stock.** Upon receipt of the purchase price in cash and/or notes, as provided in this Agreement, the legal representative of the deceased Primary Shareholder shall transfer to the Corporation that portion of the decedent's stock which is being redeemed.
7. **Insurance on the shareholders’ lives.** The Corporation shall apply for and be the owner of life insurance on the life of the Primary Shareholder. Additionally, to secure performance of the Agreement, the Corporation shall be empowered to purchase, from time to time, additional insurance on the life of the Primary Shareholder or anyone who may hereafter become a party to this Agreement. The Corporation shall possess the same rights with regard to these new policies as exist with respect to previously issued policies.

All life insurance policies pertaining to this Agreement shall be listed on Schedule "A" attached hereto.

The Corporation agrees to pay the first and all subsequent premiums as they become due and, if so requested, to give proof of payment to the Primary Shareholder within \_\_\_\_\_ days after the due date of the premium. In the event the premium is not paid within \_\_\_\_\_ days after its due date, the Primary Shareholder may make the payment, which shall be considered a loan and in which event the Primary Shareholder shall be reimbursed by the Corporation. The policyowner agrees to take all necessary actions to allow disclosure of information to the Primary Shareholder pertaining to the policies insuring his/her life.

No party to this Agreement shall execute any loans against, impair or in any manner encumber any of the above policies to the detriment of this Agreement without the written consent of the other parties, except that the Corporation may exercise any dividend options or dividend rights provided by any policy without obtaining the consent of any of the other parties to this Agreement.

1. **Right to purchase life insurance.** In the event the Primary Shareholder sells all of his/her stock in the Corporation during his/her lifetime [including disability], he/she shall have the right to purchase, within \_\_\_\_\_ days after the transfer of the stock certificate, all contracts of life insurance on his/her life appertaining to this Agreement. Further, upon termination of this Agreement for any reason, the Primary Shareholder shall have the right to purchase, within \_\_\_\_\_ days thereafter, all contracts of life insurance on his/her life appertaining to this Agreement.

In all of the above events, the purchase price shall be, as of the date of the purchase, the sum of any unearned premium plus the total cash value of the policy, if any, including the cash value of all dividends standing to the credit of the policy, less any indebtedness. If the right to purchase said policy(ies) is not exercised, the Corporation shall have the privilege of holding or disposing of said policy(ies) at its discretion.

On payment of the purchase price by the purchaser, the Corporation shall execute such assignments or releases as may reasonably be required 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. The IRS issued guidance in Rev. Rul. 79-46, 1979 - IRB 17, and Let. Rul. 9349002, suggesting that an employee's contractual right to buy a life insurance policy on his/her life, owned by the business, is an incident of ownership under IRC Section 2042. Later, in Estate of John Smith v. Comm'r. 73 T.C. 307 (1979), acq. in result, 1981-1C.B. 2, the Tax Court held that the insured's contingent purchase option was not an incident of ownership. Also, in Let. Rul. 9233006, the IRS determined 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, Rev. Rul. 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 BTA 1 (1938), acq. 1938-1CB 20; Estate of Ray E. Tompkins, 13TC 1954 (1949), acq. 1950-1CB 5.]*

1. **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 Primary Shareholder. Any stock issued to the Primary Shareholder subsequent to the date of this Agreement shall carry the same endorsement.

1. **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.
2. **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 Primary Shareholder and Corporation, who are parties to this Agreement. The Signature by the Corporation shall be by its proper officers.
3. **Termination.** This Agreement shall terminate upon the occurrence of any of the following events:
4. Dissolution, bankruptcy, or insolvency of the Corporation;
5. Written and signed buy-sell agreement covering the Primary Shareholder and other Shareholders; or
6. Written and signed mutual agreement of the Primary Shareholder and Corporation.
7. **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.
8. **Remedies for failure to perform.** If a party to the Agreement defaults or fails to complete his/her obligations under this Agreement, then such offended party may, at his/her option, seek damages, or obtain specific performance of the Agreement from a court of competent jurisdiction.
9. **Liability of insurer.** It is understood by the parties to this Agreement that in issuing policies of insurance pursuant to this Agreement, Principal National Life Insurance Company or Principal Life 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 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.
10. **Future stock sales.** Corporation and Shareholders agree that any stock sold, issued or transferred by Corporation from this date forth shall be sold, issued, or transferred subject to this Agreement.
11. **Corporate restrictions after purchase.** So long as any part of the purchase price for shares of stock sold in accordance with this Agreement remains unpaid, Corporation shall not, without the written consent of the person or persons to whom such amounts are due, declare or pay dividends on its capital stock, reorganize its capital structure (except to reduce its capital as required or as may be required by the provisions hereof), merge or consolidate with any other corporation or sell any of its assets, except in the regular course of business, or unreasonably increase the salary of any officer or employee of Corporation.

So long as any part of the purchase price shall remain unpaid, the legal representative of the Primary Shareholder, or the holder of any note issued under this Agreement, as appropriate, shall have the right to examine the books and records of Corporation from time to time and receive copies of all accounting reports and tax returns prepared for or on behalf of Corporation. If Corporation breaches any of its obligations under this paragraph and refuses to remedy such breach upon its being brought to its notice, the person who has such rights, in addition to the other remedies available, may elect to declare the entire unpaid purchase price due and payable immediately.

1. **Invalid provisions.** The invalidity or unenforceability of any particular provision of this Agreement shall not affect the other provisions hereof and this Agreement shall be construed in all respects as if such invalid or unenforceable provisions were omitted.
2. **Governing law.** This Agreement shall be governed by the laws of the state [Commonwealth] of \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

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

(Formalities of execution will (Signature of Shareholder)

be governed by local law and (Name)

should be in accordance therewith.)

 (Signature of Shareholder)

 (Name)

 (Corporation)

 By (Signature of Officer)

 (Name)

**Acceptance of Agreement**

I, (Name) , spouse of (Shareholder) , have read the foregoing Agreement, and I agree to the provisions relating to the sale of a Primary Shareholder's stock, and I do agree that the provisions shall be binding on me while this Agreement may remain in effect.

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

 (Signature of Spouse)

 (Name)

**Schedule A**

**Life Insurance Policies**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

Insured Insurer Policy No. Amount

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

Insured Insurer Policy No. Amount

**Schedule B**

(This schedule will be used only if valuation alternative one in Article 2 is used)

This day of , 20\_\_\_\_\_\_, the Shareholders and Corporation have determined the value of the stock of the Corporation for purpose of this agreement to be $ per share.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Primary Shareholder Other Shareholder(s)

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Corporation By: Signature of Officer

**Annual Agreed Value**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Date Agreed Value Primary Shareholder

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Other Shareholder

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Date Agreed Value Primary Shareholder

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Other Shareholder

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Date Agreed Value Primary Shareholder

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Other Shareholder