BUSINESS BUY/SELL AGREEMENTS

One of the biggest mistakes a business, especially a multi-owner business, can potentially make is not having a buy/sell agreement in place. In the absence of an agreement, many businesses end up closing, after the death of a partner. When a partner dies, without a buy/sell in place, both the surviving owners and the heirs of the deceased partner are put in untenable positions. The partners end up have the spouse or worse the children as equal partners, who know nothing about the business, care nothing about the business and don't want to be part owner of the business. What the do want is to be bought out. However, without a buy/sell agreement in place, there is no obligation on the part of the surviving owners to do so. In the final analysis, an agreement is agreed to because it's in both parties interest, but at a negotiated price usually substantially below value and usually on an installment basis. This is problematic for the heirs as they would be settling for less than fair value and they may really need the money up front. Also, installment agreements are dependent on the business continuing to be successful and creating the cash flow to make the installment payments Therefore, there is no guarantee that the installment payments will be made.

With buy/sell agreement in place, the price and method of the purchase is prearranged and legally binding to the benefit of both parties. The heirs benefit by getting immediate payment for the full value of the deceased partner's business interest. They also avoid the emotional toll that dealing and negotiating with surviving owners would create. The surviving partners also benefit equally by retaining 100% ownership of the business and by avoiding the emotional and financial toll of dealing with absentee owner.

However, buy/sell agreements can create a huge cash drain on the surviving partners and can affect the financial viability of the business, which is why buy/sell agreements should be funded with life insurance. This is true, even if one owner is uninsurable. Having one buy/out being funded on an installment basis, doesn't negate the value of the other owner's buyouts being funded with life insurance.

Deciding to implement a buy/sell agreement is only the first step. The next step is to decide type of buy/sell agreement to implement. There are four basic types, funded with life insurance. They are "cross purchase', "stock redemption", "wait and see" and "trusteed". The follow pages discuss how each one works and the pros and cons of each.

One word of caution. Once a buy/sell is in place, it should be reviewed periodically to address any changes in the business evaluation or circumstances. A good rule of thumb is every five years.

If you would like to learn more about buy/sell agreements or if you need to review the one you have in place, give us a call.

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https://www.forbes.com/sites/forbesnycouncil/2019/05/13/why-business-partners-should-always-have-buysell-agreements/#31b55d4b77f4