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News You Can Use

From Jay Landrum

Recently, I represented a group of clients where one principal was leaving the business and there was uncertainty as to what his rights were regarding his present interest in the business.

In fact, many businesses meet with confusion after the death, retirement or withdrawal of a partner or shareholder. Often, a Buy-Sell Agreement can solve those problems.

Read on to learn the reasons you may want to consider putting this valuable agreement in place.

5 Reasons to Your Business May Want a Buy-Sell Agreement

Buy-Sell Agreements set out the conditions under which the remaining principals of a business can acquire the interest of a withdrawing shareholder or partner. These agreements often restrict each owner's ability to transfer shares, and typically provide the terms and conditions under which the other owners can acquire another owner's interest upon death, disability, retirement, bankruptcy, termination of employment, or other specified events.

But is all of this really necessary? Here are 5 reasons why Buy-Sell Agreements are often a wise decision:

1. The Buy-Sell Agreement will clearly define the intentions of the parties.

In business, uncertainty is bad, certainty is good. Buy-Sell Agreements can provide some certainty, so that the intentions of the parties at the time of starting a business are reflected when one owner is ready to exit. For example, principals want to ensure they have the right to purchase the stock (or at least a right of first refusal), in the event one owner leaves. In fact, you'll find that working through the Buy-Sell Agreement will often uncover fundamental differences in thought that the partners never realized existed, including what they can and cannot do with their shares,

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and what happens if they quit, are fired, or otherwise separate from active management.

2. The specific terms of any transfers can be set in advance, and any transfers must be done in that manner.

Calculating the value of an owner's interest can be much easier if done in advance of the event prompting the owner to transfer his or her interest. Purchase prices may be set as a fixed price, or based on a formula applied at the time of transfer. Payments may be in a lump sum, or payable in installments, and may be secured by assets or be unsecured. The principals may also agree to periodic future valuations to fine tune the specific price or formula. In any event, the price and other terms are known to everyone, and no one is surprised.

3. Outsiders can be prevented from obtaining an ownership interest.

Partners usually get in a business together because they wish to work with *those specific individuals*. A Buy-Sell Agreement can eliminate the scenario where one principal leaves (for any reason), and in selling his interest to a third party, sticks the remaining principals with someone they don't like or have confidence in as a partner (or both!).

4. The value of the interest can be fixed for estate tax purposes.

Given the inherent difficulty of valuing private businesses, a failure to provide a valuation appraisal method through a Buy-Sell Agreement potentially opens the door to allow the IRS to impose its own value on the business upon an owner's death. *It's better for the principals to fix that value, rather than to invite the IRS to do it.*

5. The Buy-Sell Agreement can provide a market for non-liquid shares, and provide cash to the deceased owner's estate.

Many companies and principals do not have the funds readily available to buy the interest when a partner unexpectedly passes away. This could lead to the decedants' estate holding a non-liquid investment in a closely held business (and no cash available to pay any death taxes). In order to ensure funds are available to purchase the decedent's ownership interest, Buy-Sell Agreements can direct the company to secure life insurance on each of the principals, so the insurance proceeds can be used to purchase that ownership interest.

Considering the alternatives, a Buy-Sell Agreement can start to look like a vital part of a business relationship. After all, certainty is good.