BUY-SELL AGREEMENTS: PROTECTING YOURSELF, YOUR BUSINESS AND YOUR HEIRS

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Since it is now time for the big spring rush and taxes, I know that your business continuation planning is probably the last thing on your mind.

But, I am going to tell you a little story to put this into perspective. Then I will explain the different buy-sell options available.

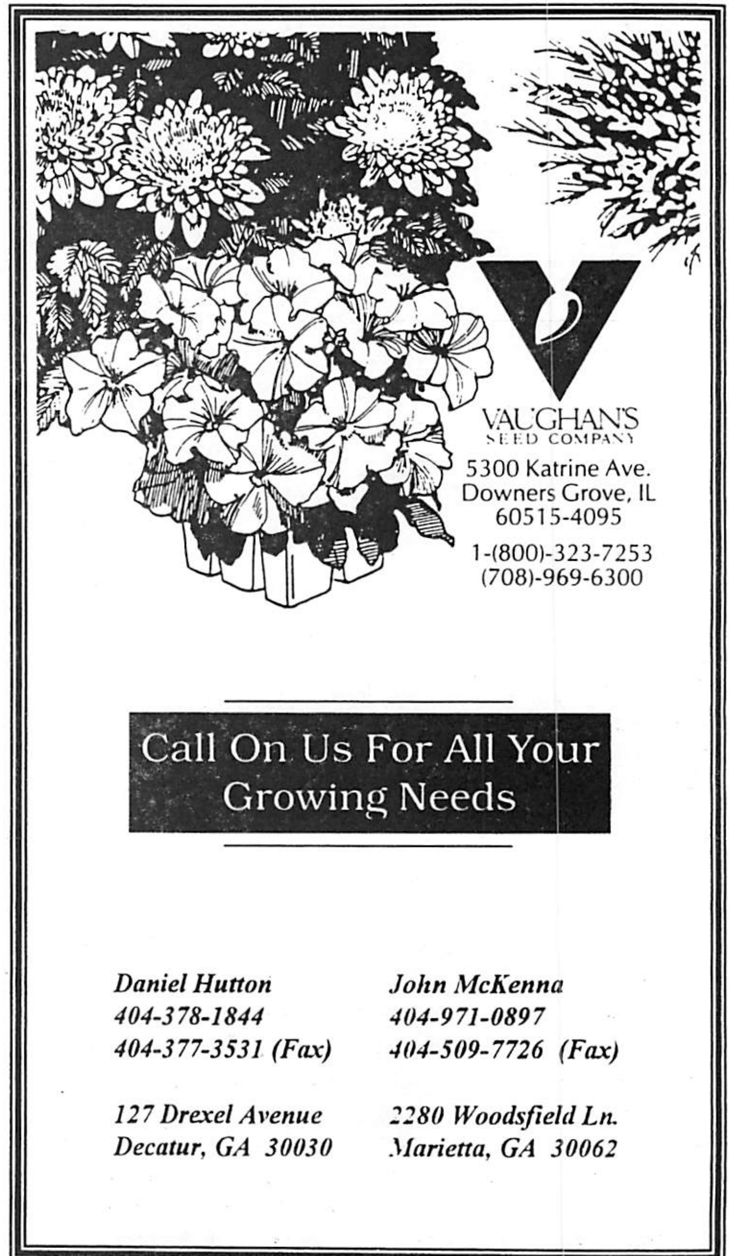
After 10 years of owning a business together, Jim and Ted were finally ready to call their wholesale and retail greenhouses a success. The early years were tough, but with two acres under cover, they were just starting to feel confident about the future. But then Ted died unexpectedly of a heart attack at age 47. Losing his business associate and close friend was a tough blow for Jim. And it didn't look like things were going to get much better. After the estate was settled, Jim found himself with a new co-owner: Ted's wife, Dianna.

It wasn't that Jim and Dianna didn't get along -- both business owners and their families had become good friends over the years. But Dianna had no desire -- and admittedly no experience -- to take over Ted's business responsibilities. With two small children at home, she needed cash to support her family until she could go to work. The only solution was for Jim to buy out her interest in the business.

But most of the business assets were tied up in inventory and loans to finance putting up new greenhouses. Neither the business nor Jim had the liquidity to buy Dianna out. After limping along for a year, steadily losing money, Jim and Dianna finally concluded the best step would be to put the business up for sale. But the loss of Ted's expertise had taken its toll on the wholesale operation's performance; the ultimate sale price was far less than either Jim or Dianna had hoped for.

Jim and Ted's story is an all-too-common one -- a successful business destroyed because its owners failed to plan ahead for their death, disability or retirement or that of their co-owner. In fact, research shows that less than 24% of owners of medium sized businesses, with revenue between $2 million and $100 million, have a formal succession plan. A simple buy-sell agreement between Ted and Jim could have saved their business and provided needed income for Ted's family after his death.

What exactly is a buy-sell agreement? Essentially it's a contract between individuals or entities which outlines the terms of transferring ownership of a business when certain events -- like death, disability or retirement -- occur.



In fact, a well drafted buy-sell agreement can resolve a number of long-term financial planning issues for a business and the people who rely on it. These include:

-orchestrating the orderly transfer of assets and business interests upon certain circumstances (e.g. disability, retirement);

-providing sufficient liquidity to the selling owner, for example, for the deceased owner's estate to meet estate settlement costs or creditors' claims;

-assuring financial stability for the surviving family;

-maintaining business continuity and credibility with customers and creditors after an owner's death, disability or retirement;

-establishing a value for the business interest and potentially setting the value of the business for federal tax purposes in non-family ownership situations; and

-creating and maintaining a funding source for purchase of the business.

Two Types of Buy-Sell Agreements

While there are any number of variations on the theme, there tend to be two basic forms of buy-sells: The cross-purchase agreement and the stock redemption agreement. Let's take a look at each.

In Ted and Jim's situation, a cross-purchase agreement could have outlined the value of the business and the value of each partner's interest. Each could agree to purchase the other's business interest, in the event of death, disability, or retirement, at that predetermined value.

The stock-redemption agreement is similar, but includes the business entity as a party to the contract. Here, the business entity would agree to buy the outstanding business interest from the stockholder's estate, again at a predetermined price. There are advantages and disadvantages of both kinds of agreements; and a lot depends on how your company is structured from both a capital and a personnel perspective.

In either case, however, the buy-sell agreement could accomplish a number of goals. It could eliminate the possibility that either owner could end up in the business with an undesirable or unqualified successor. It could give the surviving family cash to live on and potential liquidity to pay estate taxes. Also the family may be relieved of the burden of assuming business responsibilities not suitable to the current situation. And, finally, it could give the surviving business owner the autonomy and financial freedom to continue the business and maintain business credibility with customers and creditors.

A buy-sell agreement can be a vital component of any business' continuity. Smart business owners generally make this a top priority in their business plan, using the expertise of qualified financial and tax professionals to draw up the right agreement for their situation.

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