

BUY-SELL AGREEMENT BASICS

The Buy-Sell Agreement is an important part of properly establishing your business entity in order to limit liability in your business structure.

In fact, state statutes governing the statutory close corporation actually mandate that the owners enter into a buy-sell agreement. Moreover, sound business planning dictates that a buy-sell agreement also be used in a limited liability company (LLC) or conventional corporation, especially when there are two or more owners.

Every business owner will eventually get out of the business. In the absence of a child or other relative who can take his or her place, an owner needs to plan for the sale of his or her ownership interest.

Ownership in a small business can have less market appeal to one other than those already involved in the business. The first buyers to consider generally are the remaining owners.

A buy-sell agreement guarantees a buyer for a retiring or deceased owner's interest in a business, thereby allowing the owner (or the owners heirs) to recover his or her investment. The agreement also fosters the continuation of the business by not allowing the departing owners interest to fall into the hands of outsiders - persons who may not be qualified to run the business or who may be incompatible with the remaining owners

UNDER A TYPICAL AGREEMENT, THESE CONDITIONS APPLY:

- * If an owner wishes to retire, he or she must first offer to sell the interest to his or her associates, or to the business itself, before selling to a third party.
- * Upon the death of an owner, the surviving owners or the business must buy, and the estate must sell, his or her interest.
- * The purchase price is fixed or the agreement contains a formula to determine the price.

There are no fixed rules for determining which type of buy-sell agreement is most appropriate for stockholders' particular needs and objectives. However, each type of arrangement has advantages that the stockholders need to consider.

The buy-sell agreement prevents an owner from selling his interests to an outsider without the consent of the other owners. The agreement usually takes one of three forms:

- **Cross-Purchase Agreement** -- In this form, a withdrawing owner agrees to sell his interest to the remaining owners. This is the simplest form of the buy-sell agreement. It is suitable especially for the small business with only a few owners. As the number of owners increase, this form can become unwieldy. In a larger business, an entity-purchase agreement may be more suitable. Stockholders implementing a buy-sell arrangement must generally choose between a stock redemption plan and a cross-purchasing agreement. Under a stock redemption plan, the corporation agrees to redeem the shares of a stockholder at his or her retirement, death or, perhaps, disability. The redeemed shares become treasury stock. To fund the redemption, the corporation could own and could be beneficiary of a life policy insuring each stockholder. One would consider AMT (Alternate Minimum Tax) effects. Under a cross-purchase agreement, the stockholders agree to purchase the share of a withdrawing or deceased stockholder. To fund the purchase, each stockholder owns and is beneficiary of a policy on the life of every other stockholder.
- **Entity-Purchase Agreement** -- In this form of the buy-sell agreement, the withdrawing owner agrees to sell his interest to the entity, which then retires the ownership interest.
- **Hybrid Agreement** -- This form is a combination of the first two. Typically, the withdrawing owner must first offer his ownership interest to the entity. If the entity declines or is unable to make the purchase, then the shares must be offered to the other owners.

Ownership certificates must be endorsed with notice of the restriction on transfer created by the buy-sell agreement. In many cases, state statutes require that precise language be used in the ownership certificates. Thus, it is important to examine the particular state's statute and incorporate the exact required language into all ownership certificates.

Every business owner will eventually get out of the business. In the absence of a child or other relative who can take his or her place, an owner needs to plan for the sale of his or her ownership interest.

Ownership in a small business often has little market appeal to anyone other than those already involved in the business. Consequently, the obvious buyers are the remaining owners.

A buy-sell agreement guarantees a buyer for a retiring or deceased owner's interest in a business, thereby allowing the owner (or the owner's heirs) to recover his or her investment. The agreement also fosters the continuation of the business by not allowing the departing owners interest to fall into the hands of outsiders - persons who may not be qualified to run the business or who may be incompatible with the remaining owners