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Buy-Sell Agreements

Understanding the Basics

What makes for a successful business partnership? Clear communication, shared goals and mutual respect are key. But to ensure the long-term viability of your business, a buy-sell agreement is a must.

A buy-sell agreement is a legal document outlining how partners' ownership stakes will be handled should one of them die, depart or become unable to perform their duties. It's easy to put off creating this agreement, especially when so many daily tasks beckon. But delaying action can put the business's future at risk.

A Road Map Forward

Buy-sell agreements are legally binding contracts that specify when, at what price, and to whom a person's interest in a business will be sold. Typically, a buy-sell agreement permits business owners to purchase another owner's interest at a pre-agreed price. This can help ensure that business operations continue smoothly, and that they aren't taken over by outsiders who might not share the owners' vision and values. It also helps assure that owners will receive a fair price for their interest. Buy-sell agreements can help avert expensive, often lengthy disputes with surviving spouses and heirs over control of a business.

How Buy-Sell Agreements Work

Buy-sell agreements should specifically identify potential buyers, as well as events that would trigger a sale. Those events might include death, long-term disability, a criminal conviction, loss of a professional license, or resignation or employment termination.

A good buy-sell agreement should include a share purchase price or formula used to determine the value of the business. This is why a business valuation also is an important part of the process because it outlines how the business's value will be determined when a triggering event occurs. Common valuation methods include appraisals, fixed prices, or a predetermined formula based on financial metrics

It's important to base any plan's structure on the type of business, the number of owners and other unique characteristics of the business.

Funding the "Buy"

When a buy-sell situation is triggered, funds must be available to carry out the transaction. If provisions for a funding mechanism are not prearranged, a buyer or buyers could find themselves with no choice but to take out a costly loan or even sell assets. There are many ways to finance buy-sell agreements, but a common approach is to use life insurance. Life insurance is a popular solution because proceeds generally are not taxed and cash is available to purchase a deceased owner's interest. If an owner is deceased or disabled, life insurance can provide their family with cash for living expenses and estate taxes.

Types of Buy-Sell Agreements

Buy-sell agreements can take the form of a cross-purchase agreement, in which the business's remaining owners or partners buy the former partner's share of the business, or an entity-purchase agreement, in which the business itself buys the available interest.

Cross-purchase agreements are often used by smaller businesses with few owners. When a company has more owners or partners, cross-purchase agreements can become unwieldy. Life insurance policies are taken out reciprocally, meaning each owner owns and pays for a policy on the other's life, and each is a beneficiary. Because of the need for reciprocal arrangements, the number of policies needed for businesses with more owners can easily balloon.

That's why entity-purchase agreements may make sense. In this arrangement, the business entity itself owns and manages one policy per owner, simplifying administration and avoiding overwhelming individual owners.

One important consideration: Cross-purchase agreements allow partners to receive a step-up in cost basis for the purchased shares, which can reduce their future capital gains tax liabilities. Entity-purchase agreements do not.

Another type of buy-sell agreement is an Insurance Limited Liability Company (LLC) established with the sole purpose of owning, and being the beneficiary of, life insurance policies on the lives of each of the business owners.

Estate-Planning Benefits of Buy-Sell Agreements

Having a buy-sell agreement in place has several estate-planning benefits. It ensures liquidity at a fair, predetermined price, which not only can help pay estate taxes and other expenses but can help avoid conflicts between surviving owners and your heirs over business valuation. And when structured properly, a buy-sell agreement can set the value of your business interest for estate tax purposes, potentially heading off a tax dispute with the IRS.

Doing It Right

Because of their legal and financial complexities, buy-sell agreements should be created in consultation with a qualified attorney, accountant and insurance professional. Mariner has the experience and access to resources to help. Your Mariner advisor can help you get the process started.

For more information visit: **mariner.com**