Buy-Sell Agreements for Business

Planning for your future and beyond.

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Create a strategy for your business.

For most, creating an estate strategy is important to make sure your loved ones are taken care of after you're gone. But it may be just as important to have an estate strategy for your business. Whether you're a sole proprietor who will be passing on your business to your heirs or your business partners will take over for you, having a plan in place might ensure that your business legacy continues to live on.

One way to potentially safeguard a business is to create a buy-sell agreement. A buy-sell agreement is a contract between different entities within a corporation to buy out the interests of a deceased or disabled partner. A buy-sell agreement can also protect the business from loss of revenue and cover the expenses of finding and training a replacement.

When is the right time to implement a buy-sell agreement? While a buy-sell agreement can be put into place at any time, it often makes sense to set one up at a critical point in your business, such as bringing in a new partner.1

Types of Buy-Sell Agreements.

There are two main types of buy-sell agreements commonly used by businesses:

1. **Cross-Purchase Agreement.** In a cross-purchase agreement, key employees have the opportunity to buy the ownership interest of a deceased or disabled key employee. Each key employee takes out a

policy on each of the other key employees. Cross-purchase agreements tend to be used in smaller companies where there are not too many key employees to cover. For example, if your business has 3 partners, each partner will take out two (2) cross-purchase agreements to cover the other partners, for a total of 6 cross-purchase agreements.

2. **Stock-Redemption Agreement.** Stock-redemption agreements are formal agreements between each of the key employees — and the business itself — under which the business agrees to purchase the stock of the deceased or disabled key employees. Key employees agree to sell their shares to the company, often in exchange for a cash value.

These agreements establish a market value for a key employee's share of the company.2

Funding a Buy-Sell Agreement.

There are several options for funding a buy-sell agreement:

1. **Set aside funds.** Money for a buy-sell agreement can be set aside, as long as it is easily accessible. These funds must be kept up for the life of the company and may present a temptation during fiscally tough times. The business owners must determine the appropriate amount needed to cover the cost of a buyout.

2. **Borrow the needed amount.** A company can borrow enough to buy out a withdrawing key employee at the time of their death. However, the loss of the employee can often affect a company's ability to secure a loan, and the payments become an added stress on the business during an already difficult time.

3. **Life Insurance.** Purchasing a life or disability policy in order to fund a buy-sell agreement is an option when preparing for the future. Using life insurance enables a buy-sell agreement to be funded with premium payments and attempts to ensure that funds will be available when they are needed.3

Several factors will affect the cost and availability of life insurance, including age, health, and the type and amount of insurance purchased. Life insurance policies have expenses, including mortality and other charges. If a policy is surrendered prematurely, the policyholder also may pay surrender charges and have income tax implications. You should consider determining whether you are insurable before implementing a strategy involving life insurance. Any guarantees associated with a policy are dependent on the ability of the issuing insurance company to continue making claim payments.

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CITATIONS

1 - score.org/resource/covering-your-back-buy-sell-agreement [2019]
2 - fitsmallbusiness.com/buy-sell-agreement/ [07/12/2017]3 - forbes.com/sites/forbesnycouncil/2019/05/13/why-business-partners-should-always-have-buysell-agreements/#34af2d1877f4 [05/13/2019]

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