MassMutual

A STRATEGY SPOTLIGHT

Buy-Sell Plans – In General

Overview:

The disposition of a business interest is an important decision for a business owner. There are three options a business owner can consider – gift, sell, or liquidate. When a business owner decides to sell his or her business interest, a buy-sell agreement can help to ensure the sale is carried out according to carefully prescribed terms that are advantageous to the buyer as well as the seller.

A buy-sell agreement is a legal document among two or more owners or between owners and the business itself. It provides for an uninterrupted continuation and smooth transition of the business to the remaining owner or other purchaser.

For the selling owner concerned with income needs at retirement, disability, or death, a buy-sell arrangement helps to ensure a purchaser for the business interest at a fair price and the funds to carry out the obligation under the agreement. These agreements may be used by any type of business entity: sole proprietorship, corporation, partnership, or limited liability company (LLC).

KEY POINTS

- A buy-sell agreement is a legal agreement for the purchase and sale of a business interest.
- It provides for the smooth transition in control and ownership of the business.
- It offers a market for the business interest and a method to determine price.

The Agreement Identifies:

- The obligated party (generally entity, remaining owners, or key employee);
- Triggering events (i.e., death, disability, retirement, divorce);
- The purchase price or mechanism for determining the purchase price (i.e., fair market value, formula, appraisal);
- Funding for the purchase (accumulation, borrowing, life insurance, disability insurance, and/or installment payments); and
- The terms of the sale (i.e., payment period, interest, down payment).

Type of Agreements:

A buy-sell agreement can be structured in different ways: entity, cross purchase, wait-and-see, or one-way. Under an entity arrangement, both the business owners and entity enter into an agreement with the business obligated to purchase and the owner obligated to make the sale.

Under a cross purchase arrangement, the owners enter into the agreement and are obligated to purchase and sell to each other on a triggering event. A wait-and-see structure provides that either the business and/or the surviving owner(s) will have an option to purchase the withdrawing owner's interest. That determination is made at the time of the triggering event. Generally, after the initial options, the entity is required to purchase any unpurchased interests. A one-way structure obligates a key employee to purchase the business interest. The obligated party is the owner, beneficiary, and premium payor of life insurance funding the agreement.

The Bottom Line:

A business owner should have a plan for the continuation of his or her business at death, disability, or retirement. A sale to a co-owner, employee or third party is one option. A formal buy-sell agreement creates a binding contract and provides for the transition of the business with the sale carried out at an agreed-upon price when a triggering event occurs.