BUY SELL AGREEMENT
SUMMARY

A Buy Sell Agreement is a critical component to any effective business plan. Unfortunately, all too often it is overlooked, resulting in uncertainty, disruption to business operations, or even the dissolution of a business entirely. An effective Buy Sell Agreement can be used to ensure the following:

- Maintains ownership within a select group of Owners and ensures Owners the opportunity to decide who their co-Owners will be
- Establishes reasonable payment terms if the Company needs to buy out one of its Owners
- Restricts unauthorized transfers and protects against involuntary transfers
- Ensures that family members of a deceased Owner receive the value of the Owner's business interest upon the death or disability of the Owner
- Allows a business to continue operating during periods of otherwise uncertainty

The important items to consider when structuring a Buy Sell Agreement include the following:

1. Purchase on Death/Disability - Upon the death or permanent disability of an Owner, the Agreement would provide that the surviving Owner(s) would be required to buy, and the deceased Owner's family would be required to sell, the business for a pre-determined price. The primary advantage to this would be to ensure funds are available for the deceased Owner's family while also allowing the surviving Owner(s) the ability to own and control the Company(ies) without having to work with the deceased Owner's family. If an Owner becomes disabled, the remaining Owner(s) could have the option to make a buy-out mandatory (i.e., the non-disabled Owner(s) would be required to buy-out as though the disabled Owner had died) or simply grant the remaining Owner(s) the right, but not the obligation, to buy out the disabled Owner. In essence, do you want the right to require a buy-out in the hands of the disabled Owner or the remaining Owners? An Owner would be considered disabled if he is unable, for physical or mental reasons, to work for the business in the substantially the same manner he or she customarily has for a continuous period (length of time typically 6 months to 1 year).

2. Purchase on Other than Death/Disability - In the event an Owner wanted to sell or transfer the ownership of the business for any reason other than death or disability (i.e., retirement, sale to a third party, transfer to family members, or an involuntary transfer), the Agreement would provide that the other Owner(s) would have the right, but not the obligation, to purchase the interest of the transferring Owner. This could be done either for the purchase price (see below) or for a discounted amount.

3. Required Buy-Out. Sometimes clients like to add a section that requires that at the election of any Owner at any time, an Owner (an "Electing Owner") may require that either: (1) The remaining Owners purchase the Electing Owner's Interest, or (2) All of the remaining Owners sell his Interest to the Electing Owner. This provision is sometimes known as a "Texas Shoot-Out" and is used if you want to grant the Owners the right to basically terminate the business and require a buy-out at any time.

4. Purchase Price - Typically, a Buy Sell Agreement would establish a fixed price for the business which would then be re-adjusted by the owners each year. As an alternative, you could use a formula (i.e., three times the prior years net income) to determine the purchase price upon a triggering event like death or disability. The Agreement could also provide for a reduction in the purchase price in the event an owner wanted to retire prior to a certain age or for other events.

5. Life Insurance - Often times a Buy Sell Agreement is funded with life insurance to provide a surviving Owner(s) with the funds necessary to purchase the interest of a deceased owner.

6. Timing of Payments - A Buy Sell Agreement typically provides for an initial down payment (typically the greater of 5% to 10% of the purchase price or the proceeds from any life insurance) with the remaining paid out over a period of time. It is important to structure the payments to provide funds for the deceased family while not crippling the business or the surviving Owner's ability to make the payments.

For businesses with multiple Owners or for Owners who would like to incorporate some portion of permanent insurance into the Buy Sell to fund a buy out on retirement, a Life Cycle Buy Sell structure may make the most sense. The benefits of a Life Cycle Buy Sell structure include the following:

- Allows for a step-up in basis for surviving Owners
- Allows for the allocation of ownership among the Owners, allowing the Owners to reallocate the tax treatment of the premiums paid
- Avoids AMT on the death benefits paid
- Shields policies from the creditors of the Business
- Protects policies from Owner's creditors
- Agreement can be accomplished with only one policy per owner
- Avoids taxation of the death benefit under the transfer-for-value rules
- Can provide retirement benefits depending upon the type of policy
- Insurance policies can be distributed tax-free to retiring or terminating Owners

The attached diagram explains the Life Cycle strategy in more detail.

BUY SELL AGREEMENT
DATA SHEET

Type of entity: ☐ "C" Corporation ☐ Limited liability company (LLC)

☐ "S" Corporation ☐ Partnership

If Corporation (for multiple entities, fill out for each Corporation subject to the Buy Sell):

Name of Corporation: ________________________

President: __________________________________

Secretary: __________________________________

Shareholder's name	Number of shares

If Limited liability company or Partnership (for multiple entities, fill out for each LLC/Partnership subject to the Buy Sell):

Name of LLC/Partnership: ____

Managers(if any)/ General Partners: ____

____

Member's/Partner's name	Percent Ownership

How do you want the purchase price to be calculated?

☐ Current value of the company divided by percent of ownership
☐ If so, what is the current value of the company? $___________________

☐ Average of the revenue over ______ years multiplied by ____________

☐ Book Value of the Company

☐ Other ____

Do you want to reduce the purchase price in the event of a transfer other than for death or disability (i.e., early retirement, leaving the business)?

☐ Yes, ____________%
☐ No

Do you want to have a mandatory or optional purchase of an owner's interest on termination of employment for any reason other than death?

☐ Mandatory
☐ Optional

Do you want the ability for any owner to trigger a buy-out of the business by establishing a price and then agreeing to buy or sell for that amount (known as a "Texas Shoot Out")?

☐ Yes
☐ No

Are you going to incorporate life insurance to cover the cost of buying out an owner?

☐ Yes
☐ No

If yes, please provide the following information (if available):

Owner/Insured	Insurance Company	Policy Number	Face Amount

If proceeds of any insurance policy are greater than the purchase price, do you want the remainder to go to:

☐ The company; or
☐ The owner's estate

In the case an owner dies, how many years do you want to allow for the other owner(s) to pay off his the portion of the purchase price not covered by insurance?

☐ 3
☐ 5
☐ 10
☐ 15
☐ Other: _______________

What interest rate do you want to have the deferred portion of the purchase price?

☐ 5%
☐ 7%
☐ Current Applicable Federal Rate (AFR)
☐ Prime rate plus ________%
☐ Other: _______________

Do you want to include a non-compete agreement in case an owner's employment is terminated?

☐ Yes, what geographic area do you want to include? ________________________
Describe the nature of the business __________________________________
____
☐ No