Buy-sell agreements: A smart business decision also makes estate planning sense

Published on September 10, 2020

Do you own a business with one or more individuals? Undoubtedly, your ownership interest in the business represents a substantial part of your net worth and is likely your “pride and joy.” So it’s normal if your fondest wish is for the business to continue long after you’re gone or for you to keep it running if a co-owner or partner dies.

However, if adequate provisions aren’t made, the business may flounder if a leadership void isn’t filled. Or bitter family disputes may tear the organization apart. In the end, a “distress sale” may leave your heirs with substantially less than the company’s current value.

Fortunately, disastrous results may be avoided if you have a buy-sell agreement drafted during your lifetime. The agreement can dictate how the ownership interest in the business is sold, to whom and for how much. Life insurance policies are often used to fund the transaction.

Buy-sell agreements in a nutshell

A buy-sell agreement may be used for virtually every type of business entity, including C corporations, S corporations, partnerships and limited liability companies. Typically, it applies to the ownership interest in the business (e.g., shares of stock in a corporation, interest in a partnership, member interest in a limited liability company, etc.) and to any real estate used in the business that is either owned directly by the respective business owners or indirectly through a related separate entity owned by the same business owners.

Although variations exist, the agreement essentially provides for the sale of a business interest to the other owners, the business entity itself, or a hybrid. Alternatively, the agreement may cover a sale to one or more long-time employees.

The agreement, which is typically signed by all affected parties, imposes restrictions on the future sale of the ownership interest in the business or business real estate on certain triggering events (e.g., termination of employment, retirement, disability and death).

Significantly, a buy-sell agreement often establishes a formula for determining the sale price of the ownership interest in the business. The formula may be based on the business' financial statement figures, such as book value, adjusted book value, or the weighted average of historical earnings, or a combination of variables. The sale price may also be based on an independent valuation performed by an appraiser upon a triggering event. For example, the seller and buyer would each obtain an appraisal; if each appraisal obtained is within a certain percentage (say 10%) of the other, the value used would be the sum of the valuation determined by both appraisals, divided by 2; however, if each appraisal differs by more than the stated percentage (say, more than 10%), then the 2 appraisers would select a third appraiser, and the third appraiser's valuation will control and be the one used for determining the sale price.

Understanding the benefits

Having a valid buy-sell agreement in writing removes much of the uncertainty that can happen when a business owner passes away. It provides a "ready, willing and able" buyer who's arranged to purchase shares under the formula or at a fixed price. There's no argument about what the business is worth among the owners or their family members.

The buy-sell agreement addresses a host of problems about co-ownership of a business assets. For instance, if you have one owner who dies first, the ownership interest might pass to a family member who has a different vision for the future than you or the other current owners do.

Please work with us to design a buy-sell agreement that helps preserve the value of your business for your family.

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com