

Jason M. Woodward, J.D.
Financial Services Professional
Lowell, MA
financialattorney@gmail.com

Is Your Business Really Protected?

Business owners have long relied on buy-sell agreements to protect the financial future of their business and their family. Sometimes called a "business will," a buy-sell agreement is a legal contract among business owners that states what will happen should an owner leave the business due to death, disability, or a lifetime sale. The agreement obligates the remaining owners to purchase the business interest of the owner who has left the business, and the departing owner (or heirs) is obligated to sell. However, the effectiveness of a buy-sell agreement depends largely on the specific terms set forth in the agreement. If a buy-sell agreement is not properly prepared, it may cause serious problems for heirs and remaining owners.

The Two Biggest Mistakes to Avoid

A buy-sell agreement can be effective only if it's properly written. Too often, business owners overlook key areas, leaving survivors in a difficult situation. Let's take a look at two common mistakes you'll want to avoid when drafting your buy-sell agreement:

- Addressing a one-sale contingency — A poorly conceived buy-sell agreement usually addresses only one event, such as the death of an owner. This is a limited view that may lead to problems at a later date. What would happen if an owner became disabled? What if an owner wants to retire? When would the buyout be executed, and at what price and terms? A proper buy-sell agreement should address three situations: death, disability, and lifetime sale by an owner.
- Setting the value of the business too low — Some owners value their business too low in their buy-sell agreement believing that this will reduce their estate tax liability. If certain criteria are not met, the IRS can reject the business's value for estate tax purposes. Not only are the heirs shortchanged, but they may end up owing the IRS more in estate taxes than they received from the sale.

A Valid Buy-Sell Agreement

In order for a buy-sell agreement to be used to help determine the estate tax value, the IRS has set some guidelines. IRC Section 2703 gives the following requirements for a valid buy-sell agreement:

- It must be a bona fide business arrangement.
- It must not be a device to transfer property to members of the decedent's family for less than full and adequate consideration.
- It is similar to comparable arms length transactions.

In addition, applicable case law has established several rules that must be followed:

- The estate must be obligated to sell at death.
- The agreement must have a fixed and determined sale price, or a method for determining the price.
- An owner cannot sell during lifetime without first offering it to the other owners.
- The price must be fair and adequate when the agreement is made.

The Benefits of a Buy-Sell Agreement

When structured and funded properly, a buy-sell agreement can accomplish several goals, including:

- Creating a market for the stock
- Setting a predetermined price or valuation method that the owners agree on to buy and sell their shares
- Providing money to fund the plan

A buy-sell agreement benefits both surviving owners and heirs.

Benefits to heirs:

- Free of business worries
- Guaranteed fair purchase price
- May avoid probate delays

Benefits to surviving owners:

- Relieves concern of new and possible unwanted partners
- Know the purchase price beforehand
- Retain good relations with creditors and clients through a smooth transition of ownership

Doing It Right

When it comes to business succession planning, it's best to sit down with experienced professionals to plot your strategy. You should draft a comprehensive buy-sell agreement with the help of an attorney, and discuss any tax concerns with your tax advisor. It should be flexible enough to allow for future modifications with the consent of all involved parties. You'll also want to discuss funding options with your insurance agent. Insurance can be a cost-effective, tax-advantaged means of funding a buy-sell agreement.

Don't delay! Now's the time to put together a well-thought-out plan that will help guarantee the smooth transition of your business. It can benefit both your family and your business partners. For more information on funding buy-sell agreements with life insurance and for your other business financial solutions, contact **Jason M. Woodward J.D.** today at financialattorney@gmail.com.