PERSPECTIVE

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Avoid Headaches When Negotiating Buy-Sell Agreements

By Robert W. Wood

If you own all or part of a business - any business - you should know something about buy-sell agreements. So should all of your clients in any type or size of business. It applies to professional practices too. Lawyers in partnerships, professional corporations and LLPs should consider them also. Like doing estate planning, negotiating a buy-sell agreement with employees or business partners can be uncomfortable.

Of course, the need for such agreements doesn't mean they are pleasant to implement. You might choose not to sign a buy-sell agreement. Still, it's downright irresponsible not to at least consider putting one in place in any type of business or professional practice. Without it, a closely held or family business faces a world of financial and tax problems on an owner's death, incapacitation, divorce, bankruptcy, sale or retirement.

How much does a buy-sell agreement cost? The cost varies widely but they can be implemented for as little as $2,500 to $5,000. That cost is cheap compared to its potential benefits. A buy-sell agreement can ward off infighting between or among family members, co-owners and spouses.

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It can keep the business afloat so its goodwill and customer base remain intact, and avoid liquidity problems that often arise on these major events. The form of the business in question will impact the type of agreement that makes sense. As with most contracts, tax considerations play a major role. If you play your cards right, you can use the tax laws to make your deal more efficient rather than less so.

A buy-sell agreement is advantageous in virtually any type of business entity, including corporations, partnerships, LLCs and even proprietorships. How much you need a buy-sell agreement depends on how many owners there are and who else might be waiting in the wings with a financial stake in the business:

Take this example: You and your business partner Joe run a hot new mobile taco truck that parks at different locations every business day in the financial district of a major city. You and Joe are 50/50 partners. You might have a written agreement or a mere handshake. Joe dies suddenly. Do you still have a business? Is Joe's wife or child your new partner? Do you have the right or the obligation to buy out Joe's beneficiary? If so for how much and on what terms? Can you strike out on your own with a new taco stand, or are you stuck with the baggage of the old one? What if you die instead of Joe?

As this example shows, the most basic business can benefit from a buy-sell agreement, even if it's the only written document the business has. Even in a small business, disputes and confusion can result without one. The stakes go up with larger and more complex businesses. Suppose you have 10 owners in a family company and someone tries to transfer his shares to a competitor. Such events are easy to prevent with a buy-sell agreement but can be very expensive or even catastrophic without one.

One type of agreement is a cross-purchase: If you or Joe dies, becomes disabled, goes bankrupt etc., the other can buy his share. With a redemption style agreement, the business itself would make the purchase so the owners don't individually go out of pocket.

With either variety of buy-sell agreement, there is considerable flexibility. The price might be fixed, determined by appraisal or formula. The price might be paid in cash or installments over time. There can be different terms for different events, including retirement, disability, and death.

Even if you aren't a big fan of life insurance, it can often make sense to use life insurance contracts in the context of a buy-sell agreement. The idea, of course, is that insurance can provide ready funding when you need money to purchase someone's interest in the business. Life insurance can ensure that there is cash available if the time comes.

For example, whether you or Joe dies first, a life insurance policy on each of you can fund the buyout so your successful mobile taco stand stays afloat and the deceased partner's beneficiaries are bought out as agreed. Since death, disability, and retirement are rarely fun to discuss, you may find it difficult to face these issues and to make some of the myriad decisions.

But just about any buy-sell agreement is better than none. Besides, one of the advantages of the process is that buy-sell agreements are usually almost entirely reciprocal. Indeed, returning to the example of the successful mobile taco truck, no one knows for sure if you or Joe will be the first to go by death, disability, retirement, etc. That reciprocal nature makes negotiating and agreeing on these issues easier than you might think.

Buy-sell agreements are usually not terribly complex. Yet at least some of the features are not intuitive. You will probably need a business or tax lawyer experienced in buy-sell agreements to help you choose the right type and then to draft it. With proper guidance, these agreements can be surprisingly simple and cheap, especially compared to what they can potentially save and prevent. In fact, whatever you spend on a buy-sell agreement, it is likely to be a drop in the bucket compared to what it may eventually save you. Don't wait.

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