

**Abstract:** Many savvy businesses establish buy-sell agreements in case a co-owner voluntarily or involuntarily leaves. But it's not enough to draft such an agreement; the document must be periodically reviewed and perhaps updated. This article examines key aspects to re-evaluate — including triggering events, structure and funding sources.

## **Reviewing your company's buy-sell agreement**

If you own a business and follow professional advice, you've likely established a buy-sell agreement in case you or a co-owner voluntarily or involuntarily leaves the company. Assuming this is true, remember that it's not enough to draft an agreement and put it in a safe place. You need to review and perhaps revise the document periodically.

### **Problems solved**

The primary purpose of every buy-sell agreement is to legally confer on the owners of a business or the business itself the right or obligation to buy a departing owner's interest. But a well-crafted agreement can also help ensure that control of your business is restricted to specified individuals, such as current owners, select family members or upper-level managers.

Another purpose of a buy-sell agreement is to establish a price for the ownership interests. You should engage a qualified appraiser to estimate the value of those interests when first making a buy-sell agreement, and periodically thereafter to ensure the price keeps up with the growing (or shrinking) value of your company.

Estate planning is also a priority for many buy-sell agreements. If your agreement was drafted more than a few years ago, you may need to update it based on recent gift and estate tax changes. For 2017, the top rate for the gift, estate and generation-skipping transfer (GST) taxes is 40% and the exemption limit is \$5.49 million. However, also keep in mind that the President and Republicans in Congress have indicated a desire to repeal the estate tax, which might happen later this year.

### **Standard and unusual triggers**

Most buy-sell agreements lie dormant for years. What can quickly bring one to life is a "triggering event," such as when an owner:

- Dies,
- Becomes disabled, or
- Retires or voluntarily leaves the company.

But you may want to make sure your agreement also covers triggers such as changes in an owner's marital status. And to prevent fraud or inappropriate behavior, many agreements include "conviction for committing a crime, losing a professional license or certification, or becoming involved in a scandal" as a triggering event.

### **3 options**

Buy-sell agreements typically are structured as one of the following agreements:

1. *Redemption*, which permits or requires the business as a whole to repurchase an owner's interest,
2. *Cross-purchase*, which permits or requires the remaining owners of the company to buy the interest, typically on a pro rata basis, or
3. *Hybrid*, which combines the two preceding structures. A hybrid agreement, for example, might require a departing owner to first make a sale offer to the company and, if it declines, sell to the remaining individual owners.

In choosing your buy-sell agreement's initial structure, consider the tax implications. They'll differ based on whether your company is a flow-through entity or a C corporation.

### **Sources of funds**

Buy-sell agreements require a funding source so that remaining owners can buy their former co-owner's shares. Life insurance is probably the most common, but there are alternatives.

If your company is cash-rich and confident in its ability to remain so, you could rely on your reserves. However, this would leave many businesses vulnerable to an unplanned cash shortfall. Another option is to create a "sinking fund" by setting aside money for paying out the agreement over time. Again, if your cash flow *ebbs* more than *flows*, you may not have enough funds when they become necessary.

### **Worth the effort**

Keeping your buy-sell agreement updated requires some effort. But the effort will more than pay off in saved time and prevented conflicts should a triggering event occur. And if you haven't yet established an agreement, now's the time to do so.