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# Planning Considerations for Business Buy-Sell Agreements

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There are basically three reasons for business owners to enter into buy-sell agreements with their partners or coshareholders: (1) deceased or withdrawing business owners will be guaranteed a market for the business interest at a predetermined (or formula) price; (2) if properly structured, the buy-sell agreement will help peg the value of the deceased business owner's interest for estate tax purposes; and (3) surviving or remaining business owners are guaranteed full control of the business on completion of the sale.

A buy-sell agreement can be broken down into three major components. First, there are the triggering events that require a business owner to sell (or offer for sale) his or her interest in the business. The most common triggering events are death, total and permanent disability, retirement or termination of employment, transfers to third parties, and deadlock. Second is the purchase price for the business interest. The purchase price may be based on a formula (e.g., book value, multiple of earnings, or fair market value (FMV)) or may be a fixed amount that is subject to periodic revaluation. The final component of a buy-sell agreement is the payment terms. The agreement should set forth the down payment, the number and amount of any installments, and the interest rate to be used for an installment sale.

Corporations usually set forth buy-sell provisions in a separate agreement rather than in the articles of incorporation or bylaws. Partnerships and LLCs commonly include the provisions in the partnership or operating agreement.

A buy-sell agreement may be an entity plan, a cross-purchase plan, or a wait-and-see plan. In the entity plan, the corporation, partnership, or LLC buys the deceased or withdrawing owner's interest. In the cross-purchase plan, the surviving or remaining shareholders, partners, or members agree to buy the interest of a deceased or withdrawing owner. In the wait-and-see plan, at the time a triggering event occurs, the owners agree among themselves whether they, the entity, or both will purchase the interest of a deceased or withdrawing owner. Which type of buy-sell plan is preferable depends on both tax and nontax issues.

Adapted from [Advising Closely Held Businesses in Michigan](#) (ICLE, June 2000).

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