Legally Speaking
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Open For Business? Plan To Keep It That Way

Just as some couples enter into prenuptial agreements before saying "I do," business owners should consider entering into buy-sell agreements before saying "We do." As in a marriage, contingencies like death, disability or divorce, can be devastating. The buy-sell agreement is a way to plan for the unexpected and keep your "open" sign still hanging.

A buy-sell agreement is a vehicle under which the owners agree in advance how to handle issues that may arise in the future. A buy-sell agreement can address many issues or it can be drafted to address only one issue. The mind set for creating a buy-sell agreement is that it is often easier to deal with those types of issues presently than to wait until the issue becomes a reality.

Some issues which can be addressed in a buy-sell agreement are: (1) voluntary and involuntary transfers of interests to outside buyers; (2) termination of employment; (3) death; (4) divorce of a spouse if the business is community property; (5) death of a co-owner and (6) disability of a co-owner.

For example, if a co-owner dies, more likely than not, his or her interest in the business will pass to the surviving spouse or children. The question to be asked is: will the surviving owner continue to run the business with the deceased partner's surviving spouse or children as the new partner(s)? What if the co-owner becomes disabled and is unable to contribute to the business, but still draws a salary. Would the business continue to operate under this scenario?

Buy-sell agreements offer many advantages: (1) a buyer for the business will exist, (2) the business' value will be established for estate tax purposes, (3) the payment terms will be stated in the agreement, (4) there will be smooth transition in the control of the company, (5) the buyer of the company will benefit by obtaining control of the business, and (6) if the agreement is funded with life insurance, the deceased owner's estate will be assured of receiving the full value of the interest, and the estate will gain a liquid asset which can be used to pay the expenses and taxes of the estate.

Generally, there are three different types of buy-sell agreements: (1) stock redemption, (2) cross purchase, and (3) wait and see. Under a stock redemption agreement, the company must purchase the deceased owner's interest. Under a cross purchase agreement, the remaining owner(s) have the first option to purchase the interest. Under the wait and see, the parties can wait to see whether it would be more beneficial for the company or the remaining co-owners to purchase the interest. Which form to use depends on various factors such as the number of owners, the ages of the owners, and the relationship of the owners.

Since you will probably spend as much, if not more, time with your partner than your spouse, you should think of him or her as your "other" spouse. But keep in mind your vows: through profitable years and losing years, through growth years and down-sizing years, 'til death or disability do you part!

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