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Who Needs a Buy–Sell Agreement?
Benefits available to business owners

The answer to the question posed in the headline is an easy one: A buy–sell agreement can be immediately beneficial to a business owner contemplating a sale of the operation. What's more, it can provide significant benefits even if you plan to keep a business interest and eventually pass it to the younger generation.

Basic premise: Having a buy–sell agreement in place is a fundamental business practice. It can protect your family's interests in the event you become disabled or die prematurely, as well as establishing ground rules for a sale. Such an agreement is often funded with life insurance.

Buy–sell agreements are viable for virtually every type of business entity, including C corporations, partnerships, S corporations and limited liability companies (LLCs). Although some variations exist within the basic frameworks, there are three main types:

1. Cross-purchase agreements: With this agreement, a business owner agrees to sell his or her interest to the remaining co-owners or partners. Because this is the simplest form of a buy–sell agreement, it may be suitable for a small business with just two or a few owners. However, another type of agreement may be preferable for a business with numerous owners.

2. Entity-purchase agreements: As the name implies, this form of buy–sell agreement—sometimes called a redemption agreement—requires the business owner to sell his or her interest directly to the entity. Therefore, the ownership interest is effectively absorbed by the business operation.

Usually, either of the first two types of agreements will suffice, but there's a third option.

3. Hybrid agreements: This method combines the first two types of buy–sell agreements. Generally, the owner is initially required to offer his or her interest to the entity. If the entity declines or cannot make the purchase, other co-owners or partners are able to purchase the shares. Note: A hybrid agreement may also enable key employees—such as longtime company officers—to buy the interest.

Some of the benefits are almost instantaneous while others prove to be valuable over time. For example:

- Upon the death or disability of the owner, a ready-and-willing buyer is obligated to purchase shares at a fixed price or formula. Absent such an agreement, the estate or the disabled owner may be forced to sell the business at a bargain-basement price.

- The buy–sell agreement provides a smooth transfer of the business in a manner agreed upon by the owners in advance of the triggering event. This can help minimize disruptions to customers or clients while the business is in the process of recovering.

- The proceeds from the sale of a deceased owner's interest can go toward certain estate settlement expenses (e.g., death taxes and estate administration costs). In addition, part of the proceeds may be allocated to help pay the living expenses of the deceased owner's family members. If the owner is disabled, the proceeds may be used to pay all of the family's living expenses.

- The price established in the buy–sell agreement may be used to provide a valuation for federal estate-tax purposes, but see your tax adviser for more details.

Finally, be aware that state law may have an impact on buy–sell agreements. Nevertheless, the benefits are almost universal. Reminder: This is not a do-it-yourself proposition. You will want to rely on your business advisers for assistance before you make a commitment.