HBKS Wealth Advisors

Buy-Sell Agreements to Protect Businesses with Multiple Owners

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WHEN A BUSINESS OWNER UNEXPECTEDLY PASSES AWAY, selling the business or their interest in the business can become complex. Selling a business interest is not like selling most types of property; it presents a unique set of challenges, including identifying a suitable buyer.

BUY-SELL AGREEMENTS

If there are multiple owners, the surviving owner or owners might want to purchase the deceased owner's interest, but might not have the capital to do so. Yet they would want to protect that share of the business from passing on to someone unsuitable as a business partner. One potential solution is a buy-sell agreement funded with life insurance.

Buy-sell agreements provide for the sale of a business interest at the death of an owner. The future buyer or buyers are determined in the arrangement, also referred to as a "business continuation plan." Funding the agreement with life insurance can ensure buyers have the capital they need to purchase a business interest when an owner dies. The amount of the life insurance death benefit is the purchase price of the business interest as stated in the buy-sell agreement.

The agreement can be structured under an entity purchase plan — or stock redemption — or a cross-purchase plan. While ownership of the policy, taxation, and functionality will depend on which strategy is implemented, the overall goal is the same: to ensure that the business interest passes to the remaining owners or other designated purchaser, and that capital is available.

Selling a business interest presents a unique set of challenges.

ENTITY PURCHASE PLAN (STOCK REDEMPTION)

Each partner or shareholder enters into an agreement with the business that their interest will be sold if they pass away. The purchaser is the business entity itself, which buys a life insurance policy on the life of each owner. The business pays the premiums

and exists as the owner and beneficiary of the policy. When an owner dies, their interest in the business passes to the heirs of their estate. According to the agreement, the business entity then uses the life insurance proceeds to purchase the interest from the deceased owner's estate. Each of the remaining owners thereby owns a greater share of the business.

Whether entity purchase or cross purchase is more appropriate depends on the structure of the underlying business.

CROSS-PURCHASE PLAN

With a cross-purchase plan, each partner or shareholder purchases a life insurance policy on each of the other partners' lives. When an owner dies, the remaining owners buy the deceased owner's share of the business from his or her estate with the proceeds from the policies they purchased on the deceased owner's life. For businesses with multiple partners or shareholders, this strategy requires multiple insurance policies in contrast to a single policy required under the entity plan structure.

OTHER APPLICATIONS

Both types of buy-sell agreements have its own advantages. Whether entity purchase or cross purchase is more appropriate depends on the structure of the underlying business. Buy-sell agreements can also be used if a business owner were to become disabled and is no longer able to run the business.

Each type of buy-sell agreement has its advantages. Whether an entity purchase or a cross-purchase is more appropriate depends on the structure of the underlying business. For more information on implementing a buy-sell strategy for your business, contact us at (814) 836-5776, or email me at sweryha@hbkswealth.com.

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