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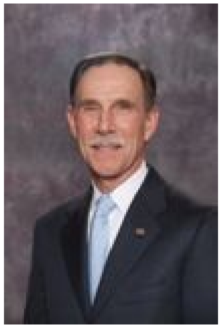

Maintain Control, Save on Taxes, and Set Fair Value Using a Buy-Sell Agreement

There is a strong case for creating a Buy-Sell Agreement for co-owned businesses. If owners agree about how to appraise business value and set the terms of payment in advance of any transfer event, they can avoid the heated and often damaging negotiations that can occur when one owner leaves the company.

In this issue, we continue making our case for Buy-Sell Agreements by outlining several other advantages of a well-drafted and recently reviewed Buy-Sell Agreement.

Controls Transfers

ownership. This agreement can assure that a selling owner (or his or her estate) is selling for fair value and under terms and conditions that are acceptable to all parties. Further, the agreement assures remaining owners that any transfers of ownership must be at least offered to them. This eliminates the potential for an outside party or a co-owner's spouse or children to assume ownership of the business, all of which could negatively affect the company's management, control, and value.

A Valuation for All Reasons

A Buy-Sell Agreement sets forth an agreed-upon method of valuing the business that applies to all transfers.

Owners' valuations of their own businesses may be much different than the IRS's or a co-owner's. If owners rely on a "stated value" or a formula-based value, they may run into difficulties with both the IRS and other owners, because value in privately owned businesses changes often and rapidly. If Buy-Sell Agreements are not revised every year, their valuation formulas will favor either the buyer or the seller, and provide ample opportunity for disputes. Owners can avoid this by requiring a value determination from a certified business appraiser, but even that provision needs to be drafted carefully.

Similarly, if co-owners buy a living co-owner's interest, the value of the selling owner's interest will likely be lower in the buying co-owners' opinion than the seller's. However, if their Buy-Sell Agreement requires the involvement of a business appraiser, they can avoid this impasse.

It is best to agree—today—on a method of valuing the business when no owner knows which side of the transfer table he or she will be sitting on. Not knowing whether you will be a buyer or a seller tends to ensure that all owners work to protect the interests of both the buyer and seller.

If owners don't have an existing, binding process for valuing the business, ideally using a credentialed business appraiser, they can expect disagreements when one of the owners leaves the business. We strongly recommend that owners take the reins and design a valuation appraisal process suitable for their companies, and we would be happy to help you do so.

In a Buy-Sell Agreement, owners can fix the terms and conditions of any transfer of ownership, including interest rate, length of buyout period, and security. In addition, it often is possible to provide the funding for future ownership acquisition, either during an owner's lifetime or after death.

Finally, Saving on Income Taxes

Buy-Sell Agreements should be drafted to anticipate the likeliest transfer event: the sale of an ownership interest from one owner to another. While they require additional planning and document drafting, intra-owner sales can be designed to save as much as 30% of the company's cash flow from taxation. For example, if the purchase price is $1 million, the cash flow required to pay a departing owner could be reduced by $300,000 or more. To repeat, this does take additional tax planning—but the result is well worth it.

We've made our case about the importance of establishing a proper Buy-Sell Agreement, and now we want to help you do it. Contact us today and we can begin creating a Buy-Sell Agreement that covers all of your business wants and needs.

specific cases, clients should consult their legal, accounting or tax advisors.