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31
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Sterling Investment Advisors Ltd.
Timothy E. Flatley, ChFC®, President

“How can a buy-sell agreement protect my family and business?”

By Timothy E. Flatley

Businesses carry a lot of risks. When they are first formed, they have survival, cash-flow and business-development risks. Once they become sustainable, a whole new kind of risk may arise: the death or disability of the owner—or, alternately, a scenario where the owner wants to stop work and sell his or her stock.

What happens then? To ensure protection of your family and finances, be prepared in advance with a buy-sell agreement.

Without such an agreement, unintended consequences may occur. The surviving owners might find themselves in business with the deceased owner's spouse, or children. Conflict might well then ensue, as the spouse and children will certainly want maximum distributions of profits, whereas the surviving owners might want to reinvest those profits back into the business.

Some surveys show that as few as 10 percent of business owners have a formal exit plan. Why? Excuses range from being too busy to attend to it, to a belief that the event is so far in the future it need not be addressed today. Then, some owners do not believe they can obtain a consensus from the other owners on how to structure an agreement. If it is difficult for the current owners to hammer one out now, how much harder will it be later for their heirs, with no agreement created at all?

There is no question that the formation of a buy-sell agreement is incredibly emotional. Most business owners cannot contemplate selling their “baby.” And when they start to think about selling, an objective valuation price is hard to get to determine.

To create a buy-sell agreement, you will need to involve an attorney, an accountant and a financial advisor. You will first need to consider whether the buy-sell will be a cross purchase (each owner buying out the other) or a stock redemption (the business buying out the owner). Tax considerations for each type would have to be evaluated.

A buy-sell will obligate the deceased/disabled/retired owner or his or her family to sell, and the other owners or the business to purchase the business interest. There will be a stated valuation or a formula to determine the purchase price. There will also be terms as to how the value is paid for. Paying a large sum in cash or borrowing funds from a bank may significantly impair the business, particularly when one of the owners is no longer there to support it. As a result, buy-sell agreements are frequently funded with insurance policies. Noncompetitive language is also included, to prevent the newly flush, bought-out family members from going into competition with the business.

Once the buy-sell agreement is complete, it should be reviewed on an annual basis. For the relatively low cost of creating it, the finished agreement will assure the viability of your business for years to come.

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