BUSINESS SUCCESSION PLANNING

When you go into business, your attention is understandably focused on developing your business plan, driving sales and making money. You usually don't have your death or the death of one your business partners on your mind. Most businesses don't, but they should.

If you or one of your business partners dies without a business succession plan in place, their interest in the business passes to their heirs and you may suddenly find yourself in business with your partner's wife or children. Business succession planning is a critical strategy to help ensure that your business continues on after the death of one of the partners in the business.

A well-thought-out business succession plan has a number of key advantages:

It will place a value on the business or a method to determine the value of the business at time of death. This lets all the partners agree in advance as to how the business will be valued so the remaining business partners can buy out the remaining share at a price that is fair to everyone.

By purchasing life insurance on the lives of the business partners for the value of their share, the heirs of the deceased owner can be assured of timely payment for their share of the business.

Life insurance gives you the peace of mind to know that buying out the other share of the business won't put a strain on your business' cash flow or force you to sell off assets to pay the bill.

The beneficiaries of the deceased owner receive a fair price for the share of the business because the price is decided on in advance, and they know the deceased business partner had the opportunity to agree to the value of the business while he or she was alive.

You won't find yourself in a sudden financial bind, so you're protected from an outside take over.

Creates an instant market for a business interest.

It facilitates the settling of the deceased owner's estate since the value of the business is known. Without it, many estates can be held up for months or years while the value of the business is determined.

TYPES OF BUY-SELL AGREEMENTS

Business succession plans, also commonly known as buy-sell agreements, have two parts. The first step is to establish a Buy-Sell Agreement, which outlines the terms of the agreement and the value of the business or the method that will be used to value the business at time of death. The second, and more important part of the plan, is to buy life insurance to fund the financial obligation and remove the worry of where the money will come from if someone should die.

Entity Purchase Buy-Sell Agreement

In an entity purchase agreement, also known as a stock redemption for corporations, the business itself will enter into an agreement with each owner to purchase the deceased owners business interest. To accomplish this, the business buys a life insurance policy on each owner’s life in an amount that equals his or her respective ownership interest in the business. The policy proceeds are used to acquire stock from the deceased owner’s estate when a “triggering event” such as, death, disability or retirement occurs. If you’d like to learn more about this type of agreement you can download our PDF outline of the pros and cons of this type of agreement.

Cross Purchase Buy-Sell Agreement

In a cross purchase agreement, business owners agree among themselves to collectively purchase the interest of any owner who dies. Using life insurance policies on each other to fund the buyout, each business owner buys a life insurance policy on all the other owners. At the death of an owner, the surviving owners receive the policy proceeds and then purchase a pro rata share of the deceased owner’s business interest from his or her estate. The result is that the estate’s non-liquid business interest has been converted into cash and the surviving owners now own 100 percent of the business. If you’d like to learn more about this type of agreement you can download our PDF outline of the pros and cons of this type of agreement.

No-Sell Buy-Sell Agreement

A no-sell buy-sell is similar to other agreements in that the control of the business and voting interest passes to the surviving owners; however, it differs in that the non-voting interest in the business remains with the deceased owner’s family or estate. This type of agreement is used when the owners want their heirs to benefit from future appreciation in the company’s value, but they don’t want the heirs to have any voting interest or to be able to take control of the business after death. If you’d like to learn more about this type of agreement you can download our PDF outline of the pros and cons of this type of agreement.

Trusteed Cross Purchase Buy-Sell Agreement

When a cross-purchase buy-sell arrangement is desired, but the number of owners and the number of policies required to fund the plan becomes too complex, one solution is a trusteed cross-purchase agreement. This type of agreement is also known as an "escrowed" or "custodian" buy-sell. If you'd like to learn more about this type of agreement you can download our PDF outline of the pros and cons of this type of agreement.

Wait and See Buy-Sell Agreement

For businesses who aren't sure whether a cross-purchase or entity purchase agreement is the best option as they are drawing up the plan, a wait-and-see agreement lets the business owners wait until the first death or other "triggering event" occurs to decide whether the business itself or the business partners should purchase the business interest. A wait-and-see agreement lets the purchaser be the business, the owners, or both. If you'd like to learn more about this type of agreement you can download our PDF outline of the pros and cons of this type of agreement.