



CHAMBER MEMBER NEWS

Why a Buy Sell Agreement Is a Critical Piece of a Business Owner's Estate Plan

By: Brittany Littleton, Founder of Littleton Legal PLLC

You have poured your energy and resources into building a successful business that not only provides a valuable service to your customers, but also supports your family, your partners, and your employees. But what happens to the company or the people you care about if you become incapacitated or die? It will be almost impossible for both your business and your family to continue to prosper if you do not act proactively. In contrast, a proper plan can ensure that your legacy continues long beyond your lifetime. A buy-sell agreement is a critical component of that plan.

The Objectives of a Buy-Sell Agreement

If you own a family-owned or closely held business with partners, you need a buy-sell agreement. A buy-sell agreement is a contract that specifies what rights and obligations you or a co-owner have to each other if either of you leave the company. The terms of your buy-sell agreement will vary depending on your goals, but it should achieve both your business planning and personal estate planning objectives by answering these critical questions:

- Who can own an interest in the business?
- Who can control the business?
- What happens upon a triggering event (retirement, divorce, bankruptcy, incapacity, death)?
- What price and payment terms will be paid by the company or remaining owners?
- How much money will you or heirs receive?

The primary business purpose of a buy-sell agreement is to define the legal rights or obligations you and your partners have to each other upon a triggering event, such as your death. In the agreement, you can restrict future control of the company to specified individuals, such as the remaining owners, agreed family members, or key employees. This can be important to you and your partners in a variety of circumstances. For example, if you die and your business interest is inherited by your spouse, your spouse and partners are likely to have different interests in key business decisions like distribution of profits, equity contributions, or day-to-day management. Your spouse may lack the knowledge or experience needed to step into your role as an active member of the company, and your partners may be unwilling to consider your spouse's opinion. A buy-sell agreement circumvents this potential conflict by establishing a fair price for your ownership interest that is then paid to your spouse (or other designated heirs) upon your death.

You may want to hire a qualified appraiser to determine the value of the company for purposes of negotiating the initial agreement, and then you and your partners can periodically agree to an updated value as the company grows. This allows you to ensure that the price payable for your business interest is fair and adequate, as you are likely to have a more informed opinion than your heirs or the executor of your estate. Absent a buy-sell agreement, the IRS may audit your business records to independently determine the estate tax value of your business interest at your death. However, if your buy-sell agreement establishes an agreed purchase price, then that amount may be used instead. This not only helps the company and your estate avoid costly appraisals and valuation disputes, but it also creates predictability that will allow you to determine what other advanced estate planning strategies may be beneficial to you.



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The primary estate planning purpose of a buy-sell agreement is to ensure that purchase funds are available to pay your estate for your ownership interest upon your death (or to pay you upon other triggering events, like incapacity or retirement). If like most business owners your net worth is largely tied to your interest in your company, then your estate may not have the liquidity needed to satisfy estate tax liability or other administrative expenses. Your business may also not have the cash to pay your estate the purchase price. If you qualify for affordable premiums, life insurance can be an ideal option to provide the company or partners with purchase money upon your death without cash-strapping the business.

A common alternative to life insurance is to agree in advance to the terms of a secured promissory note that will go into effect upon the triggering event. This method can have the benefit of deferring tax liability under the installment sale method of tax accounting. Another option is for the company to fund an investment that will be earmarked for purposes of fulfilling the buy-sell agreement. This strategy can be particularly effective with a buy-sell agreement triggered at your retirement, as you can use these funds as deferred compensation or purchase funds for a key employee who you intend to be the business successor.

A buy-sell agreement can be mandatory or optional, depending on your goals. The buy-sell agreement can be structured several ways:

- **Redemption Agreement:** The company purchases the departing owner's interest
- **Cross-Purchase Agreement:** The remaining partners purchase the departing owner's interest
- **Hybrid Agreement:** The company has the first right of refusal to purchase the departing owner's interest, but if it declines the remaining owners can purchase the interest (or vice versa)

You should consult with your attorney and CPA about what structure makes the most sense for you, as there are both legal and tax implications depending on how your business is organized and how the purchase price will be funded.

Planning for Your Incapacity and Death Beyond the Buy-Sell Agreement

While a buy-sell agreement addresses the contractual obligations that you, your partners, and your company have in the event of your incapacity or death, it alone does not avoid court interference. Guardianship and probate proceedings are unnecessary and expensive delays that can jeopardize both business continuity and the efficient administration of your estate. You can prevent these problems by completing a comprehensive personal estate plan.

If there are company decisions that require your vote during your incapacity, it could be necessary for a court-appointed guardian or conservator to vote on your behalf. A simple way to escape this unnecessary complication is to proactively designate a decision maker of your choice in a durable power of attorney. Make sure that you select an agent who understands your business and that the durable power of attorney includes express powers related to business management or ownership.

If you own your business interest in your individual name, then any contractual obligation to purchase your share of the company arising from the buy-sell agreement will likely be payable to your estate. In most cases, this will require that your estate is administered in probate court, even if you have a last will and testament. In most



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states, probate is time-consuming, expensive, and publicly invites your creditors to make claims against your estate and other interested parties to contest your estate plan. However, you can avoid probate by owning your business interest in a revocable living trust. Before you assign your business interest to a trust, you should review your operating agreement or bylaws to confirm that the transfer is authorized. You should also confirm with your estate planning attorney that your trust is drafted to empower your successor trustee to make business decisions and, if applicable, includes necessary s-Corp language.

If there is no buy-sell agreement or other governing document that addresses business succession upon your death, your business partners and heirs must rely on the default rules under state law. Without an agreement among all the business partners or heirs, this can result in the liquidation and dissolution of the company. The assets and profits that remain after company debts are paid will be incorporated into your interest and then distributed to your heirs through your estate plan or probate proceedings, depending on how your ownership interest is owned.

The Benefit of Acting Now

It is common for business owners to procrastinate developing a business succession plan because there is inherent tension between what you want for your business, what you want for your family, and what your business partners and heirs may want once you are gone. Implementing a comprehensive estate plan and business succession plan requires foresight, effort, and challenging conversations with your family and business partners. However, the time and resources that you spend now will more than pay for itself when a triggering event occurs. A thoughtful plan can minimize conflict, mitigate taxes, ensure business continuity, and protect your family's interest. After all the work you have done to build a thriving business, you deserve the peace of mind that comes from planning now.



Brittany Littleton
Founder of Littleton Legal PLLC

Brittany Littleton is the founder of Littleton Legal PLLC, a boutique estate planning and business law firm located in Broken Arrow and serving Oklahoma families and entrepreneurs. Littleton Legal helps closely held businesses minimize conflict and plan for successful futures by creating thoughtful succession plans designed to maintain a thriving business while achieving multi-generational goals.