



JM GetMoore Insurance
& Financial Services

BUY/SELL AGREEMENTS & FUNDING

A good "buy/sell agreement" should rest on an expert appraisal.

Here's why:

The cross-purchase is one of the two main ways a buy-sell agreement can be structured to provide your company with a succession plan. A cross-purchase agreement details how ownership in a business transfers if the owner dies, retires or becomes disabled. A cross-purchase agreement always involves a seller and a buyer. Ideally cross-purchase agreements ensure that sellers (or their beneficiaries) *get* a fair price for their interests, and equally important, that buyers *pay* a fair price for those interests.

Under a cross-purchase plan, each company shareholder agrees in advance to buy the shares of the withdrawing shareholder while the withdrawing shareholder agrees to sell his or her shares to the remaining shareholders.

Unfortunately most cross-purchase agreements are rarely updated. That can be a recipe for disaster. Consider the following scenario:

Years ago two friends started a construction company. At their lawyer's suggestion they signed a cross-purchase agreement; the buy-out price was set relatively arbitrarily at \$50,000. (Some cross-purchase agreements use a dollar amount; others use a formula. Any cross-purchase that does not require periodic valuation by a competent appraiser is asking for trouble, as will be obvious in a minute.)

Over the years the business grew and prospered, and before long each owner's annual salary was \$300,000. Even though the value of the business was rising, the cross-purchase agreement's exercise price was never updated. In fact the owners didn't really think much about the cross-purchase agreement at all - until the day when one of the owners suddenly and unexpectedly had a massive heart attack and died at his desk.

To make a long story short, the remaining owner cut a \$50,000 check to the deceased owner's spouse. She was incredulous. "Is that IT? This is all I get for 50% of this business? I'm calling my lawyer!" For the next two years, when the surviving owner should have been focused 100% on preserving and growing the business, instead he spent most of his time in court.

It is easy to avoid these and other equally ugly scenarios. Make sure that the cross-purchase agreement specifies an actual purchase price, determined by an objective business appraisal; and that the purchase price is updated every three years (or even more frequently if the business' results warrant). Make sure the agreement is funded so that money will be available to carry out the terms of the agreement and the purchase.

Each shareholder buys a life insurance policy on the life of every other shareholder, pays the premiums out of their own pocket and is the policy's beneficiary. Since each shareholder could have multiple policies to maintain, cross purchase agreements work best when the number of total shareholders is relatively small. For example, if a company had 7 shareholders, 42 life insurance policies would need to be purchased.

Each company's situation is going to be unique and there is no one-size-fits-all method in approaching buy-sell agreements. Factors such as the number of shareholders, their relative ages, available personal funds, company valuation, insurability, taxation and the events that mandate shareholder withdrawal must all be considered in crafting your company's buy-sell agreement.

What Is A Buy-Sell Agreement?

It's a legal document, drafted by an attorney, to provide for the smooth succession of your business upon the occurrence of a specified event. The agreement spells out the terms under which a designated co-owner, employee, heir and/or other party will buy your interest in the business if you die, retire or become disabled. The intent is to help ensure that the business continues and, most of all, that your beneficiaries receive the fair market price, in full, for your interest in the business.

Who Needs a Buy-Sell Agreement?

You may if, as a sole proprietor, partner or co-owner of a closely held business, you:

- Want the business to continue if you die, become disabled or retire.
- Have a partner, family member, or valued employee able and willing to take over the business.
- Have a spouse or other heirs whose financial security you want to ensure.

How Does it Work?

You and your successor(s) enter into a legally binding contract, commonly called a Buy-Sell Agreement, drafted by an attorney. Under the terms of the agreement, when specified events occur (such as your death, disability or retirement), the successor(s) purchase your interest; the agreement generally includes the actual purchase price or provides a formula for determining the price.

Most Buy-Sell Agreements also identify how the agreement will be funded. Funding helps ensure that funds will be available to carry out the terms of the agreement and the purchase. While there are several funding options -- sinking funds, loans, installments--insurance on the owner's life is one of the most popular options, since it helps ensure that beneficiaries will receive the agreed upon price for the business.

Why Should I Find Out More?

A Buy-Sell Agreement helps protect the interests of your successors, as well as beneficiaries not involved in the business. When life insurance is used as a funding medium, it provides the necessary cash for an immediate buyout.

Additionally:

- The full amount of proceeds is available when it is needed most, whether next year or decades from now.
- Proceeds are income-tax free in most instances*.
- The cost of scheduled premium payments is predictable.
- In cases when you have a policy that can accumulate a cash value, that value accumulates on a tax-advantaged basis. These cash values may be available to be used to help purchase a buy-out at retirement*.

At JM GetMoore Insurance & Financial Services L.L.C., we have some ideas regarding Buy/Sell Agreements & Funding that could benefit you and your business. There is no better time to re-evaluate your current situation than the present.

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