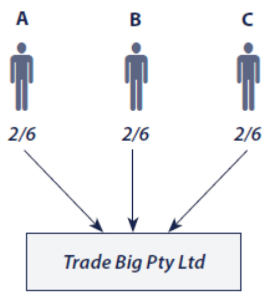
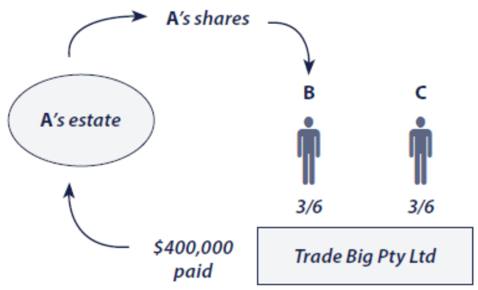
What is a business succession (buy/sell) agreement

- Two or more parties share the ownership of a business, e.g. they (or their trust, spouse, etc) each own shares in a company or units in a unit trust that carries on the business
- should one business principal die or become disabled, the continuing principals want to ensure they are able to purchase the outgoing principal's interest, and
- the outgoing principal wants to ensure his/her estate is paid a fair value for the interest.

Example



Outcome



A, **B** and **C** together own the shares in Trade Big Pty Ltd, a successful import/export business worth $1.2 million.

They enter into a business succession (buy/sell) arrangement covering death or disablement.

A is killed in a car accident. Because there was an agreement in place, there was a relatively smooth transfer of ownership.

Insurance funded buy/sell arrangements

Is of benefit where:

- a buy/sell agreement has been executed, and
- the business owners are using life insurance to provide either all or part of the funds to purchase an outgoing owner's interest.

How does it work?

Example

Assume **A**, **B** and **C** owns equally between them the shares in X Pty Ltd.

A Buy/Sell Option Agreement is in place that gives each of them the option of forcing the sale to the other of their shares should either die.

A dies. **B** and **C** exercise their option to purchase **A**'s shares from **A**'s estate. (Note: **A**'s executor could have exercised the option to force **B** and **C** to buy – it does not matter who takes this first step).

The business is valued at $1,200,000. **A**'s shares are worth $400,000. There is a life insurance policy in place on **A** for $300,000.

The $300,000 is paid to **A**'s estate leaving $100,000 to be paid equally by **B** and **C**. The agreement gives **B** and **C** time to pay this additional sum.

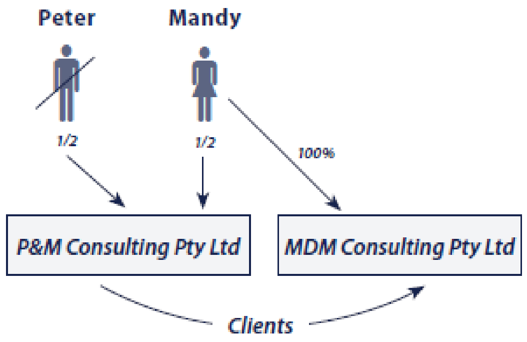
A's executor must transfer **A**'s shares to **B** and **C**. The best outcome would have been for **A** to have had an insurance policy of $400,000.

What can happen without a business succession (buy/sell)agreement

Where two or more people are carrying on a business, a business succession (buy/sell) arrangement ensures a fair outcome should one of them die or become disabled.

Problems can arise in the absence of such agreements, as highlighted in the following examples:

Example

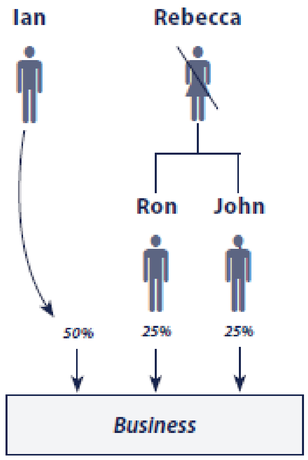


Peter and Mandy ran a public relations firm, P&M Consulting Pty Ltd.

When Peter died, his wife, as executor of Peter's estate, offered to sell to Mandy, Peter's share of the company for a fair price. Mandy declined. She set up her own business and over a period of 6 months succeeded in capturing most of P&M Consulting's clients.

The company became worthless. Mandy effectively gained Peter's share for nothing.

Example



Ian and Rebecca carried on a business supplying support materials to universities, colleges and schools.

When Rebecca died, Ian offered to purchase her shares in the company from her estate.

Rebecca's will left everything equally to her two sons, Ron and John, aged 19 and 24 respectively. Unfortunately, the boys fancied themselves as businessmen. Rather than selling, they insisted in taking an active role in the business.

After a year of indecision, arguing and no growth, the business failed.

Questions

If you have any questions please contact Stirling Financial Consulting on 02 9527 7707