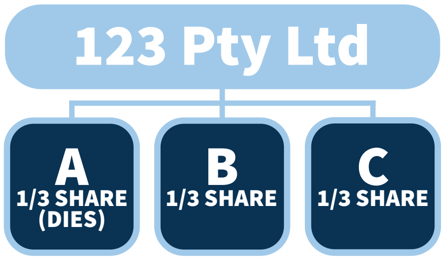
What is a Business Succession (Buy/Sell) Agreement?

When two or more parties share the ownership of a business, they each own shares in a company or units in a unit trust that carries on the business.

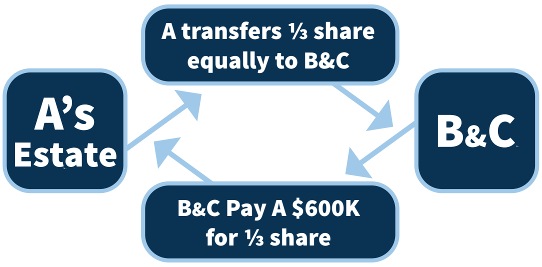
In the event one party dies or becomes disabled the other parties want to ensure they are able to purchase the outgoing party's interest and in turn the outgoing party wants to ensure that their estate is paid a fair value for their interest.

Example

A, B and C own shares in 123 Pty Ltd, a management consulting business worth $1.8 million. They have a business succession (buy/sell) arrangement covering death or disablement. "A" dies suddenly of a heart attack. Because an agreement is in place they should have a smooth transfer of ownership.



Result



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Funding Buy/Sell Arrangements with insurance

Business owners are utilising life insurance to provide the funds to purchase an outgoing owner's interest. It is imperative that if the parties intend on using insurance to fund the transfer of shares, that there is a buy/sell agreement in place.

Example

Assume Basil, Cybil and Polly own equal shares between them in ABC Pty Ltd. A Buy/Sell option agreement is in place that gives each of them the option of forcing the sale of their shares to the other should any one party die.

Basil dies. Cybil and Polly exercise their option to purchase Basil's share from Basil's estate. (Alternatively, Basil's executor could exercise the option to force Cybil and Polly to buy). The business is valued at $1.8m. Basil's shares are worth $600,000. There is a life insurance policy in place on Basil for $600,000. The $600,000 is paid to Basil's estate. Upon receipt of this money Basil's executor must transfer Basil's share to Cybil and Polly.

What happens if you do not have a buy/sell agreement in place?

The purpose of a buy/sell arrangement is to ensure a fair outcome for the parties carrying on a business, in the event one of them die or become disabled. Examples of problems that can arise if agreements are not in place.

Scenario 1

Adrian and Bob run an advertising firm Ad-Execs Pty Ltd. Adrian dies. His spouse offers to sell Adrian's share of the company to Bob for a fair price.

However, Bob decline's the offer.

Bob ends up setting up his own business (Goodbye Pty Ltd) over a period of 6 months and succeeds in taking the Ad-Execs Pty Ltd clientele with him. Therefore Ad-Execs Pty Ltd becomes worthless and **Bob gains Adrian's share value for nothing**. Adrian's spouse receives nothing for Adrian's Shares.

Scenario 2

Sherlock and Watson run a restaurant together. Watson dies and Sherlock offers to purchase Watson's share in the restaurant from Watson's estate. Watson's Will left everything to his spouse. Watson's spouse believes she has adequate management skills to run the restaurant and wants to take an active role in the business. She refuses the offer and keeps Watson's shares.

Although Sherlock did not want this to happen, he has no choice and therefore Watson's spouse becomes his new business partner. Her skills are not adequate for the business and results in profits deteriorating and no growth.

Business fails.

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