

No-Sell Buy-Sell Arrangement

Although business owners often agree in principle on the importance of a buy-sell arrangement, they may find it hard to get beyond that agreement and to the point where they can sign a final agreement.

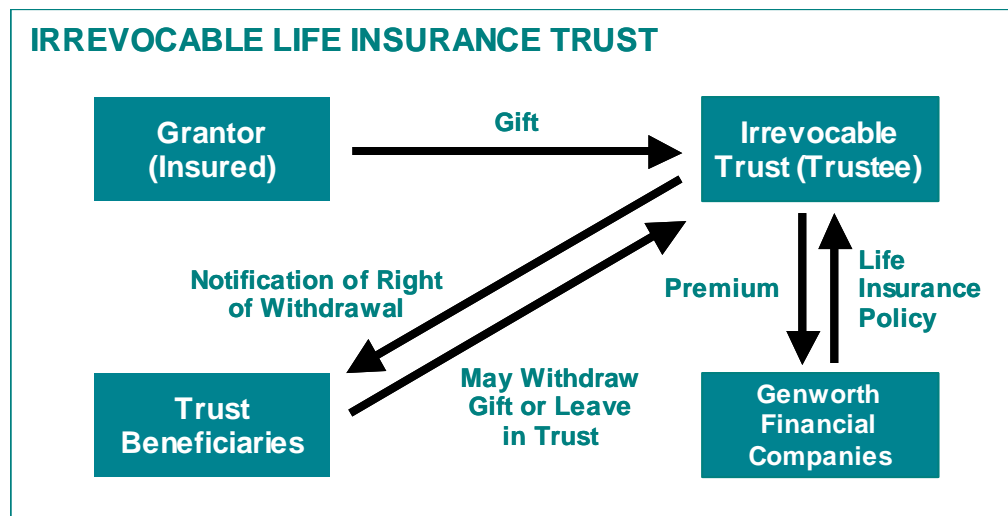
- They may not be able to agree on the value of the business.
- They may find it hard to agree on the “triggers” that require the purchase or sale of an owner’s interest.
- They may not want to cut their kids out of the future growth potential of the business.

These arrangements routinely require a family to sell what is often its most valuable asset. It is often the asset with the most potential for future growth. Business owners may be reluctant to force their family to give up that future possibility.

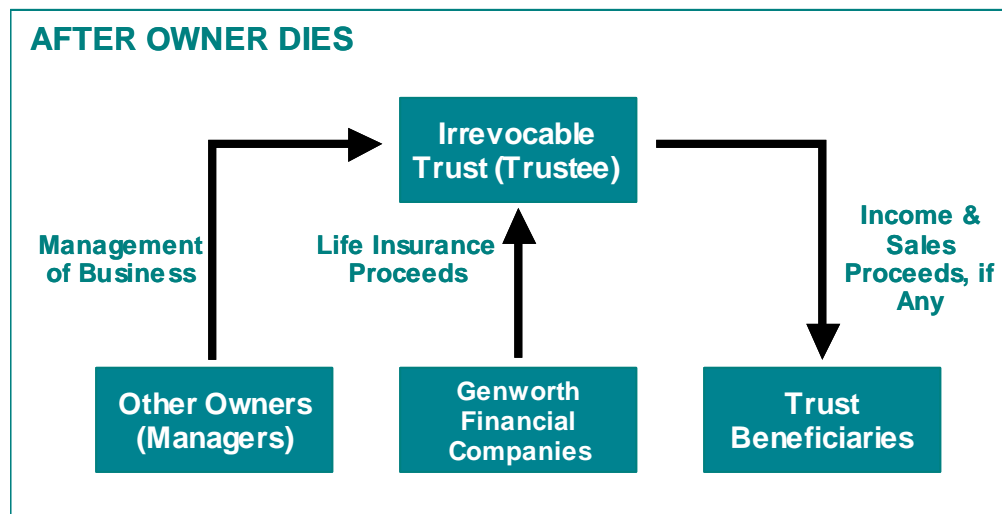
A “no-sell” buy-sell may be worth considering in these situations.

HOW IT WORKS

Instead of buying life insurance on one another or having the business buy life insurance on each owner (as happens in the “normal” buy-sell arrangement), each owner decides what his or her own business interest is worth, sets up a trust, and the trust buys life insurance in that amount.



When an owner dies, his interest in the business goes to his family. The life insurance proceeds go to the trust. The trust then uses that money to buy the business interest. Alternatively, the owner may simply leave the business interest to the trust. The trust would then pay the life insurance proceeds directly to his family. Tax advisors decide which way is best. Either way, the family gets cash while the trust gets the business interest.



A trustee (typically a spouse or child) controls the trust for the family's benefit. The company's surviving owners serve as special trustees (or managers) with power to vote the stock. This allows those involved in the business to keep control of the business. Their fiduciary duties (and often state law) restrict them from doing anything (such as voting the business interest) that is not in the family's best interest as beneficiaries of the trust. It is important to understand the potential conflict of interest the other owners may have and the difficulty they may have in separating their personal interests from those of the decedent's family. Fiduciary duties vary from state to state; it is important to seek the advice of competent legal and tax counsel.

The trust may sell the business interest when the *family* and their advisors decide it is the right time—which may be based on business value or on the family's needs:

- When the business goes public
- At the top of the business cycle
- When the business matures and the stock peaks in value
- When the family needs the money for a new home or to pay for major expenses
- When the family wants to diversify their investments
- When the trust finds the right buyer who recognizes the value of the business
- When the other owners can arrange financing to pay a price the family feels is fair

ADVANTAGES

- The family gets cash for immediate and future needs but they also benefit from any future growth of the business. The family receives money from the trust. It may also receive distributions of profits from the business.
- Creates a market for the stock when the market is best. There is usually no market for a minority interest in a closely held business.
- Active owners keep control of the business (subject to their fiduciary responsibilities) without having to pay for the decedent's interest in the business.
- This arrangement may assure customers, creditors and employees of business continuity.
- Each owner's family keeps its proportionate share of ownership—now and in the future.

CONSIDERATIONS

- Cash is needed not to buy the business interest (the typical need in a buy-sell arrangement) but to provide for those things that a sale of the business would otherwise provide—retirement income, cash to pay estate taxes, etc.
- The company may pay the premiums using a Section 162 bonus (deductible to the business, taxable income to the employee) or may use a split dollar arrangement (not deductible).
- If the business is a personal service corporation or an S corporation, it may not be prudent to transfer ownership of the stock to an irrevocable trust.

- Triggering events for the buy-sell usually include the death, disability or retirement of an owner. Other triggering events may include divorce, bankruptcy, creditor's judgment against an owner, termination of employment, conviction of a crime, loss of a professional license, or a third-party offer to buy the business.
- This idea works best with a business where it is easy to bring in new owners or if the trust has an option that requires the remaining owners to buy the interest when carefully defined conditions can be outlined.

TAX CONSIDERATIONS

- With proper planning, the life insurance proceeds can be income and estate tax free. They can be used to pay the estate tax on the business interest, leaving it intact.
- If estate taxes are a consideration, the client may want to consider having either an irrevocable life insurance trust or someone other than the insured own the life insurance policy.
- A minority discount may be available for estate (or gift) tax purposes.
- When another owner dies later, the stock owned by the owner who died earlier is not included and taxed in the later owner's estate because the survivor did not own the stock.

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