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Business Continuity Planning to Resolve Ownership Transfer Events

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Thankfully, most of us will leave our businesses by walking out of the front door, rather than by being carried out under a sheet. Good business continuity agreements address a variety of lifetime exits as thoroughly as they do the death of an owner.

A buy sell agreement can cover many other transfer events, such as:

- Permanent disability
- Sale to an outside party
- Retirement
- Termination of employment by Company
- Involuntary transfer due to Bankruptcy or Divorce Decree
- Dispute between or among owners leading to sale of ownership.

Each of these lifetime transfer events can trigger either an optional or a mandatory sale or purchase. Or, the transfer event may not trigger any right or obligation because the event is not one that the owners have chosen to include in the Agreement.

As you design a buy/sell agreement for your company, carefully consider whether each transfer event should be included and if so, whether the departing owner or the remaining ownership must or may buy or sell ownership interest. The Agreement you draft will likely have extremely important future consequences because it will govern your ability to leave the business on your terms or to acquire a departing owner's interest in an affordable manner.

For this obvious reason, the buy/sell agreement may be the most important business document you ever sign. It may be as important for several less obvious reasons.

First, valuation standards and the IRS require that the value of the ownership interest transferred under each event be consistent. For example, the method of valuation used in a death buy-out funded by life insurance and the valuation method used to purchase a departing owner's stock during his lifetime must be the same.

The buy/sell agreement typically, and appropriately, requires the same per share value to be used regardless of the event triggering the transfer. Let's assume that there are two equal owners of a business valued at $10 million. If one owner dies, his interest is valued at $5 million. Assuming that proper planning has taken place, the company or the surviving owner has acquired insurance on the deceased owner's life in (at least) the amount of the value of the deceased's interest in the company. The survivor then pays the decedent's estate $5 million and becomes the owner of the entire business.

Usually, a buy/sell agreement contains *mandatory* provisions requiring each owner (depending on the order of death) to sell his ownership to the surviving owner or to buy the ownership of a deceased owner. This design works well at the death of the first owner as that owner's estate receives the full value of his interest. It works equally well for the surviving owner provided he purchased adequate life insurance on the decedent.

What happens, however, if your co-owner doesn't die, but, instead, wants or needs to sell her ownership during her lifetime to you? Perhaps she decides to retire to the sunny beaches of Mexico or her husband files for divorce. In these cases, the obligations of each party to the other take on particular significance because lifetime transfer events are seldom fully, or even partially, funded. Fortunately, most owners will leave their businesses during their lifetimes. Unfortunately, little thought and planning is devoted to these exits despite the fact that they require more planning. In some ways, dying is the easier (but not suggested!) exit path.

When you consider what a successful *lifetime* exit holds, it will be far more meaningful to you than a successful *death* exit. I'm sure you will agree that your planning time is well spent.