

THE CROSS PURCHASE BUY-SELL AGREEMENT

Taking Care of Your Business After You're Gone

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Business owners are builders. They spend their lives building a business that provides goods and services to their clients and provides themselves a living. But nothing can tear down that lifetime work faster than their own death, or the death of a business partner. Often, much of the value of a business dies with the owner.

Each business encounters different problems. The questions facing a sole proprietor are two-fold. First, if he or she dies, how can the heirs continue the business or keep from selling the business at fire sale prices? The executor of the estate can continue the business, but must find someone willing to run it. They can sell the business, if the heirs wish, but must find a buyer. This is made harder by the fact that any potential buyers will be in a better negotiating position, knowing the business is becoming less valuable with each passing day following the owner's death. Also, the heirs may be in disagreement over what to do with the business. Some may want to keep the business, while others want to cash out. If the business is kept running by some heirs, those wanting out would need to be compensated. If the cash to do this can't be found, this could potentially force a liquidation of the business.

The second question facing a sole proprietor is this - how does the business owner keep key employees confident that the business, and their jobs, will survive after his or her death?

If a partner dies, the surviving partner can be left with uncertainty. First, they may find themselves in business with the deceased partner's heirs - who may have different goals for the company. If the heirs wish to sell to the surviving partner, can they be paid? And will the cash needed to buy the business be on hand?

These questions can throw the value and continuation of a business into doubt. This could make creditors more likely to call loans, and key employees less likely to stay with the firm.

Buy-sell agreements are designed to answer these questions and work toward eliminating these problems.²

Basically a deal struck by interested parties in the firm to sell their share of the business to another person if one should die, these agreements are often funded by life insurance. Owners take out a life insurance policy on themselves with a key person as the beneficiary. If the owner passes away, the key person can use the proceeds to buy the business from heirs. This way, the key person continues to work and operate the business. That same key person will have the funds to purchase the business, and the heirs would receive a fair price (agreed to before the owner's death). They also get an easy liquidation of the estate.¹

The business owner also benefits from the arrangement. They have the satisfaction of knowing the business will continue after their death, and that their regular employees will continue to have stable employment. In addition, the business owner may find greater productivity and loyalty from key employees, who may be aware that ownership is in their future.²

In a partnership, life insurance policies are purchased on each partner with the other partner named as the beneficiary. The proceeds from any one owner's death can be used to purchase the deceased partner's interest from the heirs. The agreement also provides some security to the heirs and the partners - assuring them that the business will continue after either of their deaths.²

As with the death of a sole proprietor, the heirs may be freed from certain business worries since the sale can happen rather quickly. They also know they won't be forced to sell the business under duress. The family will get the pre-determined fair price for the business. Also, estate issues will be settled more quickly allowing them to move on with their lives.¹

Buy-sell agreements, whether between sole proprietors or partners, do have disadvantages.⁴

First, the participants have to trust and verify that each partner keeps his or her policy in force. This isn't as simple as making sure the premiums are paid. Usually the policies are owned personally - not by the firm. If a partner goes through a bankruptcy, creditors may go after the cash value of the buy-sell agreement's life insurance policy.

Also, the more partners involved, the more policies must be taken out. Two partners require two life insurance policies, but a partnership of three will require six policies - each partner will be the beneficiary of two other partners. Thus, as the number of partners increases, the number of policies grows exponentially - as does the cost of the buy-sell agreement.

Finally, if the partners have a wide disparity in age or health, the older or less healthy partner will be paying much more for the agreement than the younger, healthier partner.

Before you make a decision about how you'll protect the future of your business, it may be wise, in addition to researching your options, to speak to a qualified professional who can guide you through these complex options.

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