



# Why Your Business Needs a Buy-Sell Agreement

Protect the future of your business and your loved ones

If you're like many successful business owners, the longevity of your company is a primary concern for you. Business continuation planning can help you ensure that your company will endure, regardless of what the future may have in store. And it can help to ensure the financial security of you and your loved ones. But if your focus has been primarily on the day-to-day operation of your business, chances are that business continuation planning is something you've put on the back burner.

A buy-sell agreement can help you protect what you've worked so hard to build. Business owners who adequately plan for the continuation of their firm in the event that they should die or become disabled can help to ensure the continuity of their business for the long term — and, just as importantly, the financial security of their loved ones.

## What is a buy-sell agreement?

It is a legal contract that obligates surviving owners, or the company itself, to buy out the interest of an owner who dies or becomes disabled. The agreement may also spell out other triggers for a purchase or sale, such as the retirement of an owner, the criminal conviction of an owner, and more.

A buy-sell agreement ensures that there will be a ready market for your business interest should you die, become disabled or otherwise leave the business. The agreement also spells out methods to determine a fair price for your ownership interest.

## Ways to structure a buy-sell agreement

There are several ways to structure a buy-sell agreement. Each is dependent upon the number of owners, the legal structure of the business entity, and tax considerations.

Generally, however, the three main types of agreements are:

1. cross purchase agreements;
2. entity purchase agreements; and
3. wait-and-see agreements which are a hybrid of the first two.

## A buy-sell agreement offers powerful benefits:

- Transforms your business ownership into a liquid asset
- Establishes a valuation for your business
- Creates a market for your business interest
- Prevents unwanted changes in ownership
- Helps you save on taxes
- Helps establish the value of your business for estate tax purposes



## The three main types of buy-sell agreements:

- **The cross purchase agreement:** Requires a co-owner buy out the interest of a deceased or departing owner.
- **The entity purchase:** Obligates the company to buy out the interest of a deceased or departing owner. For corporations, the entity purchase is also known as a stock redemption plan.
- **The wait-and-see purchase:** A hybrid that allows the company and owners to defer the choice between cross purchase and entity purchase until a triggering event. This allows the owners and the company to react to financial conditions and tax issues at the time of the triggering event.

## Funding Your Buy-Sell Agreement

When properly funded, a buy-sell agreement can:

- Establish a ready market to purchase your business
- Establish a value for the purchase price of your business
- Identify future buyers of your business
- Identify the events that would trigger your buy-sell agreement
- Provide a source of funds necessary to make your arrangement effective

There are several ways to fund a buy-sell agreement. Funding the agreement means that when a triggering event occurs, there is a ready source of funds to pay the buy-out price. The typical methods of funding an agreement include:

- **Reserves** – If your company maintains cash reserves, it might be able to dip into those reserves, although for many businesses, they are insufficient to pay the buy-out price.
- **Borrowing** – Oftentimes, credit is an impractical and expensive solution. That assumes that the lending institution is even willing to loan money to the company or to co-owners, since one of the owners has died or left the business.
- **Installment Sales** – Self-financing the buy-out from business cash flow is typically impractical or as expensive as using reserves or borrowing – and it ties up valuable cash flow.
- **Life Insurance** – Life insurance is the most economical and practical solution for funding your buy-sell agreement. Policy benefits<sup>1</sup> are paid out when the triggering event occurs and by using permanent life insurance, cash values can be used to partially fund a lifetime buy-out.<sup>2</sup>

Ensuring that your business remains strong and can continue to grow by overcoming the loss of one of its owners requires proper business continuation planning through a properly funded and structured buy-sell agreement.

## Learn More Today

**Contact a Guardian Financial Professional to learn more about what kind of buy-sell agreement would best fit the needs of your business and your loved ones.**

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Pub9803 (2/19) 2019-73386 (Exp. 2/20)

<sup>1</sup> Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal may also be subject to a 10% tax penalty.

<sup>2</sup> All whole life insurance policy guarantees are subject to the timely payment of all required premiums and the claims-paying ability of the issuing insurance company. Policy loans and withdrawals affect the guarantees by reducing the policy's death benefit and cash values. Disability provisions, including disability buy-out insurance should also be considered to fund the buy-sell arrangement in the event that it is triggered by the disability of one of the participating owners.

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