Buy Sell Agreements

Notes on Shareholders or beneficiaries (buy-sell) agreements

A buy-sell agreement is an arrangement or contract between family business shareholders or beneficiaries that specifies certain ownership rights among owners of family business shares or partnership interests. Buy-sell agreements are about planning for the possibility of difficult family business circumstances and enable shareholders to agree in advance how situations will be handled. They are complex documents requiring specialist legal and tax advice.

These agreements provide a mechanism for dealing with potential conflicts, and protect shareholders and the business by providing a means to achieve liquidity while keeping demands for funds manageable.

In general, the agreements focus on shareholders' rights to transfer shares (or ownership interests) in the business to other people, circumstances that activate those rights, and transfer mechanism procedures. Specifically, these agreements entitle shareholders to buy each other out under certain conditions and at a certain price, and to have first right of refusal when someone decides to dispose of shares.

Buy-sell agreements can restrict who may be the owner of the business. They can formalise agreement not to sell shares to anyone outside the identified group (spouse, child, grandchild, or trusts established for them or the company itself) without prior approval of family shareholders. Those receiving shares (or beneficial interests) are also bound by the agreement.

Distinctions can also be made between *mandatory* and *voluntary* buy-sell shareholder (beneficiaries) agreements. Mandatory agreements obligate shareholders (or their estates) to sell shares in a family business to identified buyers upon the occurrence of a triggering event such as death, disability, resignation, retirement, attainment of a certain age or divorce. In contrast, voluntary buy-sell agreements restrict persons to whom shares can be sold, willed or gifted.

Buy-sell agreements also provide a method for pricing shares to be sold (usually arrived at in consultation with a valuation expert to be truly reflective of the business' continuing value). Means of payment of shares can also be specified, with life or disability insurance covering either the total (death trigger purchase) or the major part (retirement trigger purchase) of the purchase price.

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Checklist of main decisions to be made:

- Who may own shares in the business and under what circumstances the shares may, or must, be sold? Specify the persons, (e.g. sons, daughters, sons/daughters-in-law…) and the criteria for ownership (e.g. anytime, only if employed, never, other...
- What events require a sale of shares back to the company or other owner? Specify the event(s) (e.g. no event, death, disability, divorce, termination or employment, other…)
- Circumstances under which a shareholder may sell to the company or other shareholders. Specify the circumstances (e.g. no restrictions, only annually, only if they sell all shares, other…)
- Valuation for buying and selling shares. Specify types of shares/beneficial interests and valuation methodology (e.g. agreed formula, by appraisal, by agreement, to be negotiated, other…) Valuation discounts can apply to minority interests. Assets such as real estate may be valued separately. Consider tax implications.
- Terms of payment. Specify terms (e.g. immediate, over 'x' years, interest rate, security, guarantee(s), other terms…) A significant lump sum may be paid immediately and the balance over a number of years (e.g. five or ten years with interest) Structuring the insurance policies is a specialist field and requires expert advice.
- Funding. Specify funding methodology (e.g. shareholder agreement not funded, funded with insurance, funded with financial statement reserve, other…)
- Other terms and conditions…such as voting rights and other considerations (e.g. requisite majority before company can be sold, composition of Board of directors, obligations to preserve company tax status, pre-emptive rights of existing shareholders, etc.)

**This article by Lucio Dana & Harry Kras is for general information only and should not be relied on as, or in substitution for, professional advice.*

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