



CNB BUSINESS[®] BROADCAST

NEWSLETTER FOR BUSINESS CLIENTS OF CANANDAIGUA NATIONAL BANK & TRUST

Does Your Business Need a Buy-Sell Agreement?

When you're mired deep in the day-to-day challenges of the management of your business, it's often hard to step out of the trees and take a good hard look at the forest. But at various points in the business cycle, it's important to do just that. For example, one of the key decisions you'll need to consider is what would happen to your business if you decide to step away, or you die or become permanently disabled. A buy-sell agreement can be a useful tool in helping you plan for these circumstances.

What is a buy-sell agreement?

A buy-sell agreement is a legally binding agreement that establishes when, to whom, and at what price you can sell your interest in a business. Buy-sell agreements are also known as business continuation agreements and buyout agreements.

You can create a buy-sell as a separate agreement or you can include certain provisions addressing the buy-sell issues in a business's operating agreement. Regardless, the agreement or provisions must clearly identify the potential buyer, any restrictions and limitations, and the conditions under which a sale will occur. Under the terms of the agreement, you and the buyer enter into a contract for the transfer of your business interest by you (or your estate) at the time of a specified triggering event. Typical triggering events include death, long-term disability, retirement, divorce, personal insolvency or bankruptcy, criminal conviction, loss of professional license, and resignation or termination of employment.

A well-crafted buy-sell agreement creates a market for your business interest, establishes its price, and provides cash to complete the business purchase. The ability to fix the purchase price as the taxable value of your business makes a buy-sell agreement especially useful in estate planning. That's because if death is the triggering event, it can help reduce the estate tax burden on your heirs. Additionally, because funding for a buy-sell agreement is typically arranged when the agreement is executed, you're able to ensure that funds will be available when needed, providing your estate with liquidity that may be needed for expenses and taxes.

Pricing the company and funding a buy-sell agreement

A buy-sell should establish a formula for determining the purchase price or state the price outright. Without establishing this price in advance, lengthy disputes and lawsuits can arise at the time the ownership interest must be bought back. When the buy-sell involves family members, it must also be proven that the transaction is comparable to an arms-length sale

between unrelated people and was entered into for a bona fide business purpose.

After determining the value of the business, you, your advisors, and other parties to the agreement will determine the best way to fund the transaction and the triggers appropriate for your business situation. There are many different ways to fund a buy-sell agreement, including a sinking fund, cash, borrowed funds, installment sale, self-canceling installment note, private annuity, life insurance, and disability insurance. Depending on the situation, one or more of the possible methods may be used.



Types of structures

Buy-sell agreements can be structured to meet the needs of both the business and its owner(s), taking into consideration tax consequences and individual goals. Following are three types of buy-sell agreements, along with brief descriptions of each:

- An **entity purchase (or redemption) buy-sell** obligates the business to buy the interests of the departing owner(s).
- With a **cross-purchase buy-sell**, each owner agrees to buy a share of the departing owner's interest. The business is not a party to the transaction.
- A **wait-and-see buy-sell** is used when the parties are unsure whether the business or the owners will buy the business interest. Typically, the business is given the first option, and if it is not exercised, the remaining owners are given the opportunity. If the remaining owners do not wish to buy, the business must purchase the interest.

Other considerations

Keep in mind that there are costs and possible disadvantages involved in establishing a buy-sell agreement. One such disadvantage is that the agreement typically limits your freedom to sell the business to outside parties.

If you think that a buy-sell agreement might benefit you and your business, consult your attorney, accountant, and financial professional.

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Owning or Leasing Space for your Business?

Whether you are a long time business owner or just starting out, you will want to consider owning your space or leasing. In order to determine what's best for you, consider the following questions:

1. Can you handle the up-front costs?

If you plan on financing the purchase, you will need to come up with a down payment, which is usually between 10% to 25% of the purchase price. You will also be required to pay certain costs and fees associated with closing the real estate transaction. Is the space move in ready or will you need additional financing for furniture, equipment and improvements.

2. What are the tax benefits?

You will want to check with your CPA for a comprehensive review of the impact to your specific situation.

3. Is there a potential for rental income?

Having a tenant could help defray the costs associated with owning your own space, help increase your cash flow or pay down the existing mortgage on the property.

4. Is there room for growth?

You will want to be sure you have room to grow if you plan to expand your business down the road.

5. How can you benefit from equity and asset appreciation?

If you are taking a mortgage on the property, your monthly payments will go towards paying down the principal loan amount, allowing you to build equity in the property. As you pay it down, you may be able to tap into it as a source of equity for your business. As for asset appreciation, the property may increase in value over time, giving you additional capital if you choose to sell the property.

CNB offers a variety of commercial financing solutions with competitive fixed or variable rates, and both short-term and permanent real estate financing. What makes us unique in the market? We are currently offering¹:

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If you have any questions or would like to discuss your options, please see a Bank Office Representative.

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