

# BUY-SELL AGREEMENT



Do you want to be in business with your partner's spouse?

The issue of succession within a business is important and is something that should be discussed amongst principals and equity holders.

One way to protect your interests and minimise disruption to the business when a co-owner departs or exits the business is to enter into a Buy-Sell Agreement.

## What is a Buy-Sell Agreement?

A Buy-Sell Agreement, also known as a buyout agreement or business will, is a contract between the co-owners of the business and governs the situation if a co-owner dies, is forced to leave or chooses to leave the business.

The agreement ensures that continuing co-owner(s) are bound to manage the exit of the former co-owner by pre-agreed terms, which may include buying out the interests of the former co-owner. It establishes clear and precise sequence of events necessary to decide what is to happen to an exiting principal's equity and any subsequent transfer of the business interests including valuation and timing. The agreement predetermines those exit events that you wish

to cater for, and it recognises the need for funding.

## What type of exit events can a Buy-Sell Agreement cover?

Some common triggers for Buy-Sell Agreements include where one of the following occurs to a principal:

- Death
- Total or permanent disablement including mental illness
- Diagnosis of a major disease or condition identified as a trauma event
- Voluntary retirement or resignation
- Bankruptcy
- Conviction for a serious criminal offence

Trigger events not directly related to a principal may include where there has been a resolution of a specific majority of owners to either offer the business for sale to an identified purchaser or expel a principal.

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## How is the transfer funded?

### ■ Insurance Funding

An insurance Buy-Sell Agreement is often recommended by business-succession specialists and financial planners to ensure that the arrangement is funded and to guarantee that there will be money when the exit event is triggered. In these instances, the insurance proceeds are set off against the amount required be paid by the remaining owners to buy out the exiting owner.

### ■ Other Funding

Where an exit event occurs which is not covered by insurance funding, pre-agreed finance or instalment arrangements are followed.

## Does it matter what type of business structures are in place?

It does not matter what business structure has been used to own or run the business or if there is more than one entity involved in running the business.

## Are there any tax advantages of having an insurance Buy-Sell Agreement?

There are certain tax and capital gains advantages of setting up an insurance Buy-Sell Agreement. In particular, payment of life insurance proceeds may be excluded from the application of capital gains tax. However care should be taken in relation to proceeds paid for trauma or other non-life cover because failure to pay the proceeds to the

injured party or his/her relative may result in capital gains tax.

Another aspect to consider is linking your life insurance policies to superannuation accounts. Depending on your circumstances, this may seem advantageous as contributions to super funds are tax deductible, whereas contributions to personal life insurance policies are not however care must be taken that you do not breach the sole purpose test pursuant to section 62(1) of the Superannuation Industry (Supervision) Act 1993.

Also, considering what type of insurance protection is being taken is important - asset cover (against an owner's equity), debt cover (against liabilities of the business) or key person cover (against the loss from reduced revenue or goodwill), the types of transaction that will flow from the payment of the insurance proceeds and any subsequent tax consequences of these transactions. Having the insurance policy held via an insurance trust on behalf of the insured can allow you to implement other tax planning strategies when the insurance proceeds are distributed to the business or co-owners in relation to debt and key person cover.

## Summary

A Buy-Sell Agreement, incorporating insurance funding, protects your investment and ensures the survival of your

business should one of the business owners or a key person die, become totally and permanently disabled or suffers a critical illness. The agreement allows you to plan for the future succession of your business.

Prior agreement on issues such as mechanisms by which equity is valued, under what circumstances a business owner can leave or be expelled and the rights of the equity holders, can circumvent lengthy and costly legal disputes.

Planning ahead to agree on a commercial strategy in dealing with these issues is smart business practice and will save costs and frustration in the longer term.

## More information

To learn more about the Topdocs Buy-Sell Agreement, [visit the website](#) or call the team at Topdocs on 1300 659 242.