Buy-Sell Agreements:
Resources to help our next generation of farmers

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What is a buy-sell agreement?

A ***buy-sell agreement*** is a contract obligating one business owner to buy all or a portion of the business upon the retirement, death or disability of another business owner. The contract specifies who will buy the ownership interest, what price will be paid and how the interest will be bought. Terms of the sale and when the sale will occur are also included. Funding is an important aspect of this planning technique and is usually accomplished with current cash flow, loans, life insurance proceeds or through the sale of other assets.

Why have a buy-sell agreement?

A buy-sell agreement allows the business owners to establish the value of the company and the value of ownership interests in a mutually beneficial agreement for all owners and their families. The agreement also avoids or reduces disruptions to the business operations after one owner leaves the business because the event has been planned for and management will continue. Planning for the future in this way assures business stability and continuity and provides job stability for the buying owner and other key employees. A buy-sell agreement also prevents outsiders, off-farm heirs, or unqualified shareholders from obtaining an ownership interest. The agreement creates an immediate market for the owner's interests and creates orderly liquidation. Cash provided by the buyer allows for continuous income to a disabled owner or payment of estate taxes and settlement costs to a deceased owner's estate.

There are three types of buy-sell agreements including a cross purchase agreement, an entity purchase agreement, and a wait-and-see buy-sell plan.

Cross Purchase Agreement: Each business owner buys a life insurance policy on the lives of the other owners. Under the agreement, the owners are obligated to use the proceeds from the insurance at the death of an owner to purchase the business interests from the deceased's estate.

Entity Purchase Agreement: The business itself is obligated to purchase the business interests of the deceased using life insurance policies that the business has purchased on each of its owners. The company incurs the cost of the life insurance and also retains the cash value instead of the individual owners.

Wait and See Buy-Sell Plan: The business itself has a first right of refusal, and therefore has the first right to buy the deceased owner's shares. The business can wait to decide whether to purchase the share or let the remaining owners purchase the shares personally. If the business elects to let the remaining owners purchase shares, it is required to buy any remaining shares that remaining owners do not purchase.

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