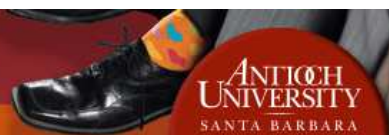


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BUSINESS

Brad Tisdale: What Happens to Your Business If Something Happens to You?

Planning for the unexpected protects the company and the interests of all parties

By Brad Tisdale for Mission Wealth Management | Published on 07.29.2011 9:41 p.m.



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Many people embrace their dream of owning and operating their own business outright or in a co-ownership arrangement with partners and/or shareholders. They diligently work over the years building the company with the day-to-day focus of running the company and maximizing the company's value.

They envision some day in the future a planned exit of the business, which may occur by transitioning the business to the next generation or selling it to a third party. Their equity in the company may account for part or their entire retirement portfolio. In the meantime, their hard work in the business is what provides the income to fund their family's needs and lifestyle.



Brad Tisdale

But what if there is an unplanned exit? Is there an emergency plan in place for an unexpected and untimely exit of a business owner because of disability or death? Or perhaps one of the partners decides to leave the business and wants the other partners to buy out his interest in the company. What contingencies have been made to ensure the business doesn't go off course because of the unplanned exit of one of the business partners or shareholders?

Partners and those with an ownership interest should know the answer to these simple but often unasked questions:

- » What happens to the business if something happens to me?
- » Will the surviving partners buy out my interest in the business from my family or estate?
- » If so, will it be at a fair price, and how will the value be determined?
- » Does the company have funds readily available for this?
- » Similarly, what happens to the business if something happens to one of my partners?
- » Will his family step into his place or try to sell his interest to a third party?

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The answers to these questions, like any contingency planning, are best addressed ahead of time versus after the fact when emotions are high and there are many unknowns and potential conflicts of interest. These issues are best addressed in a legal document called a buy-sell agreement or as part of the shareholders agreement. There are a few different ways to structure the agreement, such as an agreement between partners or a formal agreement between company

(entity) and each individual owner.

Regardless of structure, a buy-sell agreement has many benefits and protects the interests of all parties. For example, it guarantees a buyer and a seller in the event of death, disability and retirement. It establishes how the fair market value of the company will be assessed, which in turn will be used to determine the value of the exiting owner's interest.

Once established, the agreement should be properly funded. This means that company resources need to be identified ahead of time for the purpose of funding the potential buyout of an owner. One option is a "sinking fund" where the company systematically sets money aside into a specific account for this eventuality. Borrowing the funds when needed is an option, but with loan interest it can be the least cost-effective approach. Also, the loss of an owner can have an adverse financial impact on the business, and lenders may be unwilling to provide the necessary credit.

Life insurance is the most cost-effective funding solution as it provides an instant buy-out fund when there is a triggering event. The company can own a policy on each of the owners, or the co-owners can own policies on their fellow shareholders. The proceeds of the policy will be used to buy out the interest from the deceased owner's family. Life insurance provides liquidity for the buyout and protects the company's cash and assets from the buyout requirement.

Term life insurance policies are most affordable for this purpose, but the benefits of utilizing permanent life insurance policies should not be overlooked. Although more expensive than term life policies, permanent policies provide greater flexibility to the company as they have a cash accumulation component to them. The accumulated cash value in a permanent life insurance policy provides liquidity to help buy out the interest of a retiring partner. The cash value of a permanent policy is considered a company asset, and funds from the policy can be borrowed.

During the life of the business, all of these decisions will have to be made at some point, so it is best to make them ahead of time. Once completed, it will be a relief to all, and the owners can get back to running the business and doing what they love without the concern of "what if" something happens.

— *Brad Tisdale, MS, CSA, is the director of insurance services at **Mission Wealth Management**. He can be contacted at btisdale@missionwealth.com or 805.690.3874. [Click here for more information.](#)*

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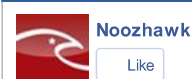
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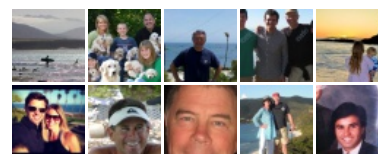
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