

ESTATE PLANNING NEWS



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Avoid Family Disputes: Buy-Sell Agreements for Business Owners

Buy-sell agreements are essential succession-planning tools for closely held businesses. As part of your estate plan, a buy-sell agreement provides a quick and indisputable way of valuing shares and determining how your estate should dispose of them.

A buy-sell agreement typically calls for your estate to sell company shares back to the business (or to the surviving owners individually) at a predetermined price.

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Announcements

Real Property Tax Bills Issued

Attention homeowners! If you recently created a revocable living trust, check your real property tax bill and verify that you are receiving your \$7,000 homeowner's exemption.

If the exemption does not appear, call your County Tax Assessor to request and complete a new homeowner's exemption card. The exemption is worth about \$70 each year.



Tip of the Month

Make Your Healthcare Future More Predictable

As life expectancy increases and healthcare expenses grow, it becomes more and more difficult to accurately predict future healthcare needs.

While hoping for the best, one solution is to prepare for the worst. Ask your financial advisor or insurance provider whether long-term care (LTC) insurance is appropriate for you.

LTC insurance assures that your healthcare needs will be met so that your assets may be preserved for you and your heirs.



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The man does better who runs from disaster than he who is caught by it.

-- HOMER
The Iliad

Avoid Family Disputes

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A buy-sell agreement benefits both the business and the deceased owner's estate. First, it enables the business to continue operating, without interruptions or disputes over the price of the shares. Second, it provides a ready market and fair price for the decedent's shares.

3 Elements of a Buy-Sell Agreement

A buy-sell agreement is a contract among business owners or between each owner and the company. Typically, the business's founders create the agreement, and it becomes part of the corporate bylaws, shareholder agreement or partnership agreement. The business can then update the buy-sell provision periodically. For a buy-sell agreement to work effectively, it should include at least three elements.

(1) Restrictions on share transfers

A buy-sell agreement's requirements may come into play when:

(a) An owner wishes to retire or withdraw from the business

He must first offer to sell his shares back to the company or remaining shareholders before accepting an offer from an outsider.

(b) An outside party makes a bonafide offer for one owner's shares

The owner must first offer his shares to the company or other shareholders.

(c) A shareholder dies

The company, or its shareholders, must buy the deceased owner's shares from his estate at the price stated in the agreement.

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Entertainment

Just Like Heaven (2005)

Shortly after David Abbott (Mark Ruffalo) moves into a San Francisco flat, he is greeted by the last tenant, Dr. Elizabeth Martinson (Reese Witherspoon). A spectral romantic comedy, this movie may make you reconsider the decisions you made in your Advance Health Care Directive.



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(2) Pricing mechanism

Without a predetermined price or formula for valuing the shares, buy-sell provisions are meaningless. The most common pricing formulas are:

(a) Book value

Book value equals assets minus liabilities (as shown on the most recent balance sheet) divided by the number of outstanding shares. Since this method usually undervalues the shares, the valuator sometimes uses a multiple.

(b) Multiple of earnings

The valuator multiples last year's earnings per share by a fixed number. The multiplier varies depending on the industry.

(c) Percentage of gross income

This varies depending on the industry.

(d) Yearly valuation

The owners meet annually and agree on the value of the shares.

(e) Appraisal

An outside appraiser or arbitrator establishes the share price at the time of the buyout.

(3) Funding the buyout

The agreement should provide for a cash source to buy shares from a deceased owner's estate. A buyout is often funded by life and disability insurance - also known as "key person" or "business value" insurance.

Avoid Disputes and Disruptions

If you die without a buy-sell agreement, your shares pass to your beneficiaries as provided in your trust or will, or according to state law.

What disputes and disruptions may result?

- Your heirs may wish to sell shares back to the company, but the company may not offer a fair price.
- Your heirs may wish to sell shares to an outsider, but the outsider may be incompatible with the other owners.
- Your heirs may decide to keep the shares and get involved in the business, but lack the necessary expertise or rapport with the surviving shareholders.

A buy-sell agreement prevents these types of problems. It guarantees the estate a buyer for the shares, who will pay a fair price. It also ensures a smooth continuation of the business without incursion by unwanted outsiders.

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