**8806. What is a buy-sell agreement?**

Buy-sell agreements are often used in business succession planning where the business is owned by a relatively small group of owners who would otherwise have a limited market in which to sell their business interests. A buy-sell agreement can provide the remaining shareholders or co-owners with the option and/or requirement of purchasing the business interests of a deceased or withdrawing co-owner before the business interest is sold to a third party. This power is important because it can control how the business interest is to be disposed of and who will become the business owner’s new partner in business.

Business entities such as closely held corporations (Q 8776), LLCs (Q 8797), and partnerships (Q 8761) frequently rely upon buy-sell agreements when creating future business succession plans. A buy-sell agreement is essentially a contract to buy and sell a departing business owner’s interests in a business at some point in the future, usually upon the occurrence of one or more specified events.[[1]](#footnote-1)

A buy-sell agreement is typically structured as either a cross-purchase agreement or a redemption agreement. A cross-purchase agreement is an agreement among co-owners to purchase each other’s business interests upon the death or other withdrawal of one or more owners from the business. These agreements typically specify a predetermined purchase price and, in some cases, are funded by life insurance purchased to insure the lives of the various business owners.

A redemption agreement allows the business entity to purchase the interest of a deceased or withdrawing business owner upon the occurrence of previously agreed upon “triggering events.” See Q 8811 for a discussion of the different considerations that apply depending upon whether the agreement is structured as a cross-purchase or redemption agreement.

It is also possible to structure a buy-sell agreement so that it combines features of the cross-purchase agreement and redemption agreement.[[2]](#footnote-2) In these situations, the buy sell agreement will first provide the entity with the option to purchase the interest; to be followed by the remaining owners having the option to purchase; to be followed by the entity having the requirement to purchase. In addition, the buy-sell agreement can involve a contract to sell to a third party or another entity.

See Q 8807 for a discussion of the importance of buy-sell agreements in business succession planning. Q 8808 outlines the primary methods for funding a buy-sell agreement and Q 8809 outlines the use of life insurance in funding the agreement. Q 8811 to Q 8813 provide an in-depth analysis of the differences between the redemption and the cross-purchase forms of agreements.

1. . *Stephenson v. Drever*, 16 Cal. 4th 1167 (1997). [↑](#footnote-ref-1)
2. . See *Jacobs v. Commissioner*, TC Memo 1981-81, Rev. Rul. 69-608, 1969-2 CB 42. [↑](#footnote-ref-2)