**8817. What is a right of first refusal? What is the difference between a right of first refusal and a buy-sell agreement?**

A right of first refusal requires that a selling business owner give his or her co-owners or the business entity itself the opportunity to purchase certain business interests at the same price that he or she is able to obtain from a third party investor.[[1]](#footnote-1) The co-owners will also be given the option of matching the terms of the competing offer before the selling owner is able to sell his or her interests to a third party.

If a price has been agreed to for the sale of the business interest with a third party, this price would be strong evidence as to its being a fair value for purposes of valuing the business interest. In contrast, the agreed upon value contained in a buy-sell agreement may not fix the value of the interest for estate and gift tax purposes.[[2]](#footnote-2) It can be considered as one of the factors that could determine its value.[[3]](#footnote-3)

While a right of first refusal may provide comfort to all business owners in that they know they will have a right to purchase a departing business owner’s shares before third parties are given the right to purchase such shares; business owners must remember that in the context of a closely-held business, there is often a very limited market for the shares. Even if a business owner is able to find a third party buyer, the remaining business owners will then be forced to come up with a matching purchase offer, which may prove difficult in the small business context when funds are more limited.

Further, a right of first refusal often gives a departing business owner the power to find a willing buyer that the remaining business owners may be forced to accept in the event that they are unable to match the purchase price. As the departing business owner will no longer be involved in the business’ operations, he or she may not be the person best suited to choose a replacement owner.

In the context of a buy-sell agreement, if the triggering event is the withdrawal of one business owner, only the remaining owners or entity itself have the right to purchase the departing owner’s interests. The price or method for determining the price will be fixed by the agreement, and the agreement has often been pre-funded with insurance or accumulated earnings in order to ensure that the remaining owners are able to make the purchase. Therefore, the buy-sell agreement is often the more advantageous method for planning a departing business owner’s transition.

1. . See *True v. Comm.,* 390 F.3d 1210 (2004); *Oldcastle Materials, Inc. v. Rohlin*, 343 F. Supp. 2d 762 (2004). [↑](#footnote-ref-1)
2. . *Fry Est. v. Comm.*, 9 TC 503 (1947). [↑](#footnote-ref-2)
3. . *James v. United States,* 148 F.2d 236 (1945). [↑](#footnote-ref-3)