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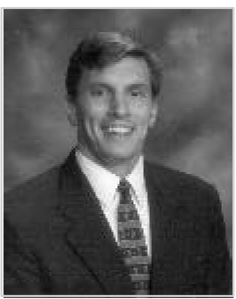
Cummings-McClorey Davis & Acho, P.L.C. Attorneys & Counselors at Law

# An Overview of the Buy-Sell Agreement for Co-Owners of a Business



*Christopher G. Schultz*

When multiple owners form a business, they typically enter into the venture with confidence and an overly optimistic expectation as to their relationship with one another. However, there are a number of personal and business issues that can have a detrimental effect on the relationship between the co-owners, hinder the performance of the owners and ultimately impact the profitability and success of the business.

When entering into a business relationship, potential situations that could cause a disruption between the owners should be reviewed. Some of those situations include death, permanent disability and retirement of an owner. There are other situations that may not be anticipated, but are important to consider, including bankruptcy or divorce of an owner, termination of employment with the company, violation of the internal governing agreements or the inability to continue in the working relationship.

The purpose of the buy-sell agreement is to grant certain rights to the business and the owners of the business to buy out the interest of a deceased, disabled or retiring owner. Typically these provisions provide that the business or the other owners would buy out the deceased, disabled or retiring owner at a price equal to the fair market value of their interest in the business. Often these agreements are funded with disability or life insurance policies to provide the funds required to purchase the interest from the estate of the deceased or disabled owner. In other situations, the buy-sell agreement would provide that an owner's interest be purchased for something less than fair market value and likely over a longer pay out term.

There is also a potential situation when the majority of the owners of a business can threaten to exert control over the business and the interest of a minority owner, such as selling their interest to a third party, reducing their compensation, funneling contracts to related entities or otherwise attempting to diminish the value of the minority owner's interest in the business. All of these situations should be addressed in a buy-sell agreement. The buy-sell agreement would establish the price and terms of the payout and provide adequate protection to both the business and the owners.

A buy-sell agreement includes other considerations, such as the ability to finance or pay the purchase price, whether the purchase would be by the company or by the other co-owners, relevant tax consequences and whether one of the events would require the purchase of an owner's interest or merely grant an option to purchase the interest under the circumstances.

Attorneys in our corporate and business group are well versed and have substantial experience drafting and negotiating buy-sell agreements and enforcing the terms of the agreements for both the majority owners and the minority owners in various business situations. If you are in, or plan on entering into, a business relationship consideration should be given to preparing a buy-sell agreement to protect the interest of all parties.

*Christopher G. Schultz*

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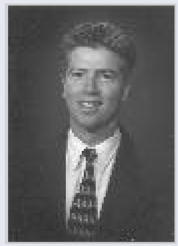
## in this issue

# CMDA Happenings

Attorney Speaks on Workplace Discrimination Issues


*Christopher K. Cooke*

Last month Christopher Cooke, a partner in our Traverse City office, spoke on workplace discrimination issues and the operation and function of the Equal Opportunity Commission at the Upper Peninsula Human Resources Association conference.

Attorneys Present Seminar on OMA

Andrew Brege, an attorney in our Grand Rapids office, and Haider Kazim, a partner in our Traverse City office, recently gave a presentation on the Open Meetings Act (OMA) during Michigan Municipal Risk Management Authority's (MMRMA) winter workshop held in Lansing, MI.

Mr. Brege and Mr. Kazim are the editors of the "Michigan's Open Meetings Act Handbook." Topics covered at their presentation and in the handbook include, who is covered by the OMA, what rules do municipalities need to follow when having a meeting, when can a closed session be held and enforcement and liability issues under the OMA.

If your municipality is interested in attending an upcoming OMA presentation, or scheduling your own, please contact Mr. Brege at (616) 975-7470 or abrege@cmda-law.com or Mr. Kazim at (231) 922-1888 or hkazim@cmda-law.com.

# The Top Ten Estate Planning Mistakes


*Linda Davis Friedland*

We have all heard the probate horror stories. Someone's Will took five years to be probated, generating hundreds of thousands of dollars in attorneys' fees. All of the assets from someone else's estate were stolen by the personal representative (executor), leaving the family with nothing. The probate judge was unfair. Such stories instill fear about probate administration, which can lead to estate planning decisions with unintended consequences. The following is the first part of a two-part series on the top ten estate planning mistakes one should avoid:

1. Adding Children's Names to Residential Deeds, Vehicle Titles, Brokerage Accounts, etc.

More often than not, this is a very bad idea. Adding a name to a deed, title or account conveys ownership, with all the legal rights and responsibilities that go with it. Parents usually regret this decision once they learn that they cannot sell, mortgage or even refinance their home without their children's consent and involvement. For bank or brokerage accounts, distribution checks cannot be cashed or rolled over without the signature of all listed owners. Perhaps the most important concern is liability exposure. Assets to which children's names are added are at risk for levy by the children's creditors.

Capital gains taxes are a rarely considered, but very important concern. In most situations, when one sells a capital asset, such as a home, the tax assessed would be based on the difference between the sales price and the original purchase price. This is known as the "tax basis." Typically, when a child inherits a home from his parents, he enjoys a "step up" basis, meaning his tax basis would be the value of the home at the time of the parents' death. Then, if the child immediately sells the home, there would be no capital gain.

If the child is added to the deed prior to the parents' death, however, he will only enjoy the step up in basis for the percentage of the home he did not own prior to his parents' death. Depending on the value of the equity in the home, adding a child's name to the deed may create a "taxable event," requiring the filing of a federal gift tax return.

2. Leaving Everything to One Child, with the Understanding that He or She "Will do the Right Thing."

Many parents will add the name of just one of their children to their assets, with the understanding that this child "will do the right thing" for his siblings. Typically, the selected child is either the oldest, the perceived smartest, or simply the one who happens to be still living at home. These arrangements are almost always an invitation for probate litigation, especially when the selected child feels entitled to more than his fair share.

3. Having Estate Planning Documents Prepared by an Inexperienced Attorney.

Some inexperienced attorneys present seminars for the sole

*continued on page 3*

# COMMUNITY COLLEGE CORNER

Patrick R. Sturdy

Community colleges often spend a significant amount of time and effort developing written policies and procedures to ensure the college complies with State and Federal law, various administrative rules and accreditation requirements. However, simply adopting policies and procedures is not enough. Colleges must make sure administrators, staff and faculty, not only understand the policies and procedures, but also follow them.

Deviation from the policies and procedures, even by one administrator, staff or faculty member, can have dire legal consequences for both the college and the administrator, staff or faculty member. For example, failure to follow the college's policies and procedure on academic discipline could result in a court finding the college and/or administrator, staff or faculty member violated the student's Constitutional due process rights. As another example, failure to follow the policies and procedures adopted for a special program at the college could result in the loss of accreditation, thereby depriving students of the benefits of the program and damaging the college's reputation, not to mention the potential monetary damage arising from litigation.

A college can protect itself from these hazards by annually informing administrators, staff and faculty members of the college's policies and procedures. If an issue arises, administrators, staff and faculty need to review the college's policies and procedures before making any decision on how to handle the situation.

## The Top Ten Estate Planning Mistakes (cont.)

purpose of scaring people away from probate, and toward more costly estate plans involving the use of trusts.

These attorneys may not mention, however, that some smaller probates may be completed quickly in Probate Court, with just a simple will. While estates with complex tax considerations typically require the use of trusts, some estates could benefit from administration through the Probate Court. An experienced planning attorney will take a detailed history for each client, analyze it and then provide the pros and cons for each estate planning option.

### 4. Poor Trustee Selection.

If an estate plan requires a trust, the most important decision with respect to the plan will be selection of the trustee. Michigan law provides enormous power to trustees. In most situations, the selected trustee will manage and distribute your assets without court supervision.

Too often, parents will select a favored son-in-law or best friend who happens to be "good with numbers." This should never be the primary consideration. Trustees are usually permitted to hire attorneys, accountants, financial planners and other professionals, to assist in the administration of the trust. Instead, the individual selected to serve as trustee should the one believed to be the most trustworthy. The trustee should share the client's goals and values, and should have a clear understanding of how the client would want his assets to be managed and distributed. Absent court intervention, the trustee will have complete control over the trust's checkbook.

### 5. Improper Tax Planning.

An estate plan which reduces probate fees will not necessarily reduce the federal estate tax. Probate fees are governed by state law, and the federal estate tax is calculated according to the Internal Revenue Code and corresponding Treasury Regulations. For example, naming a beneficiary on an insurance policy will avoid probate, but the face value of the insurance policy could still be subject to the federal estate tax. Depending on the total value of the estate, the applicable tax rate could be as high as 35% for 2012, and even higher once the current tax law sunsets.

The tax rates, and the formula for calculating the federal estate tax, have changed often in recent years. Experienced estate planning attorneys will keep abreast of the changes in the tax laws, and advise their clients accordingly.

Look in next month's newsletter for the remainder of the top ten estate planning mistakes one should avoid.

*Linda Davis Friedland*

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### Our Vision

*To meld our legal expertise, professional support staff, technical resources and variety of locations to deliver first rate legal services at a fair value to a full range of business, municipal, insurance and individual clients.*

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Comments and questions regarding specific articles should be addressed to the attention of the contributing writer. Remarks concerning miscellaneous features should be addressed to the attention of Jennifer Sherman.

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