Don’t Forget DI
Buy-Sell Agreements Using Disability Insurance
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- Estate Planning
- Charitable Giving Arrangements
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Sale of a Business Interest in the Event of Disability

Updated by Todd A. McGee, JD, LL.M

Overview: Don’t forget DI. Disability Income insurance is often overlooked in business succession planning. Permanent disability is more likely to occur during one’s working life than death. This edition of the Advanced Underwriter explains the use of Disability Income insurance in a buy-sell agreement as used for business succession.

The Facts are Very Compelling

It’s hard to imagine a fellow business shareholder/partner becoming disabled and unable to support the ongoing operation of the business, but it does happen more often than one would think. Most people don’t anticipate a disability impacting their career; however, the facts tell a different story. The risk of becoming disabled is significant: According to the U.S. Census Bureau, nearly 17% of working-age Americans reported a disability in 2010. Of those with a disability, 17.5% were employed compared to the 65% of working-age Americans with no disability in 2015.¹

Further, according to the U.S. Bureau of Labor Statistics, 39% of all workers in private industry were participating in short-term disability income insurance in 2015; 32% were participating in long-term disability income insurance.¹

Here are some other interesting statistics:

- Just over 1 in 4 of today’s 20 year-olds will become disabled before they reaching age 67²;
- Over 39 million Americans are classified as disabled, about 12% of the total population. More than 50% of those disabled Americans are in their working years, from 18-64;³
- 8.8 million disabled wage earners, over 5% of U.S. workers, were receiving Social Security Disability Insurance (SSDI) benefits at the conclusion of 2016⁴;
- In December of 2016, there were over 2.1 million disabled workers in their 20s, 30s and 40s receiving SSDI benefits⁴;
- 53.9 was the average age of disabled-worker beneficiaries in 2015.⁵

The benefits of a well-crafted and appropriately funded buy-sell agreement triggered upon the death of a business owner is generally recognized and appreciated. Unfortunately, many business owners who are concerned about selling their business interest upon death are not as concerned about selling their business interest if they become totally disabled. This mindset is unfortunate because the problems, with respect to the disposition of a business interest, can be as detrimental upon total disability as they are upon the business owner’s death. Furthermore, the probability of a business owner being afflicted by a long-term disability during the owner’s working lifetime is substantially greater than the risk of death during those working years.

² Social Security Administration, Fact Sheet, June 2016.
³ U.S. Census Bureau, American Community Survey, 2015.
⁴ Social Security Administration Disabled Worker Beneficiary Data, December 2016.
The total disability of a business owner places him or her in the unenviable position of having to maintain an interest in the business while they are physically or mentally disabled. This can create a severe strain for all the parties who are involved in the business. First, the owner who is disabled obviously must struggle with two burdens at once – the disability and the business. As a result, the financial burden created by the disability requires protection of both family income and daily business operation expenses. In addition, there is also the possibility that the disabled owner’s interest in the business may be sold. Second, the family of the disabled owner may be left in a position of uncertainty about their future. Third, the business associates of the disabled owner may be left to struggle to keep the business running, thereby straining the relationship amongst all the partners. Finally, both the creditors and the customers of the business may experience an unsatisfactory change in the policies and practices of the business after the owner becomes disabled. This could adversely impact all involved with the business if the disabled owner tries to carry on notwithstanding his or her incapacity.

At least a partial solution is for a buy-sell agreement to include disability buy-out provisions, with terms similar to the purchase of the business interest at death. Of course there are circumstances existing upon the disability of the business owner which may not be present at the owner’s death. However, these differences should not obscure the advisability of including disability buy-out provisions in the agreement. As part of the agreement, the purchaser or purchasers should agree to buy, and the business owner should agree to sell the interest in the business if the business owner becomes totally disabled.

There are several factors to consider in preparing for the potential disability of a business owner:

- The agreement is required to purchase a disabled owner’s interest.
- The definition of disability for this purpose.
- The length of time the owner must be disabled before the buy-out is triggered.
- Whether the buy-out is mandatory or optional, and how the agreement is to be enforced.
- With respect to the business interest itself, how its value will be determined and by whom, and when (at the time of disability or later when the buy-out triggers).
- Whether the purchase price is fair and reasonable.
- Whether the buy-out is made in a lump sum or under an installment sale.

In a disability buy-out agreement, the parties should be clearly identified with their obligations to buy and sell in the event of an owner’s disability. Also, the price or the method of establishing the price should be specifically set forth. Funding the buy-out with a disability income insurance policy should help assure that money will be available to execute the purchase (subject only to the insurer’s ability to meet its financial obligations, all premiums being paid when due, etc.).

A disability buy-out agreement is specifically designed to help buy out the business interest of an active owner who becomes totally disabled. The potential conflict between the active owners and the disabled owner may be avoided if they enter into a properly drawn disability buy-out agreement and fund it appropriately. Such an agreement provides for the acquisition of the disabled owner’s share by the surviving business associates and for the payment to the disabled owner of an agreed upon price for the business interest.
Three Types of Disability Buy-Out Agreements

As with any buy-sell agreement, the buy-out of a disabled owner’s interest can occur in one of three ways – either by an entity arrangement where the business itself buys back the interest (an entity agreement), or by a cross purchase where the remaining owners buy the disabled person’s interest, or by a trusteed agreement.

1 | Entity Purchase Buy-Sell Agreement

An entity purchase buy-sell agreement is a legal agreement between a business entity and its owners. To illustrate how it works, assume a business is owned equally by A and B. They each enter into an agreement with the business for the purchase and sale of their respective interests. Typically, the agreement is binding, in that it obligates both A and B, and their estates, to sell, and the business to buy, upon the disability of either one of them.

The agreement establishes a value of the business interest to be bought. In the event of an owner’s disability, the agreement typically provides for the transfer of the ownership interest in exchange for cash or cash and an installment note. Once the departing owner receives the cash, the business interest is transferred to the business.

2 | Cross-Purchase Buy-Sell Agreement

A cross-purchase buy-sell agreement is a legal agreement among the owners that provides for the planned disposition of their interests in the event of a disability. To illustrate how this works, assume a business is equally owned by two individuals, A and B. They enter into an agreement providing for the purchase and sale of their respective interests. Typically, this agreement is binding and obligates both parties, or their representatives, to either buy or sell upon the disability of either one of them.

There may be situations in which an entity-purchase agreement could be preferable even with two or three owners. For example, where the oldest owner has the largest interest in the business, a cross-purchase agreement would require the younger owner, usually lower-paid, to make the larger premium commitment. An entity-purchase agreement would pool the premium burden, and be easier on the younger owner.

3 | Trusteed Cross-Purchase Agreement

A trusteed cross-purchase agreement is a legal agreement between a third party trustee and the partners or stockholders that provides for the planned disposition of their ownership interests in the event of a death, disability or retirement. The trustee or escrow agent acts to carry out the obligations of the partners or stockholders.
Why a Buy-Out is Funded With DI Insurance

The same rationale for using a life insurance policy to fund a buy-sell obligation upon the death of a business owner applies to using a disability income insurance policy to fund a buy-out obligation upon the total disability of a business owner. Admittedly, depending on the value and the cash position of the business, it may be possible to use current cash or borrowed funds to help purchase the disabled owner’s business interest. However, from a simple economic point of view, using current cash is often an expensive way to purchase a business interest. Even if the business has sufficient capital, insurance may still be the best way to fund the buy-out.

Because the purchase of a business interest is not a deductible expense, after-tax dollars are needed. For example, in a 34% tax bracket, it takes $151,515 before-tax dollars to leave $100,000 after taxes.

Premiums for disability buy-out (DBO) insurance are a non-deductible expense. The benefits, however, are generally received income tax-free and can be used for the business purchase.

Upon the disability of an owner, the business may be obligated to continue to carry the disabled owner and pay salary and benefits for an indefinite period of time. In addition, the disabled owner is often still entitled to a share of profits and maintains his or her share of the overall business. The DBO insurance policy provides a means to buy the interest of a disabled owner, generally over a period of years, once it is evident the disabled owner is not going to return. The payment can be a monthly amount or a lump sum.

Definition of Disability

The concept of “disability” as it relates to an owner’s active participation in a business is often far more difficult to define and describe than are most other buy-sell triggering events. Setting forth the conditions under which an individual is deemed to be disabled is essential to a successful arrangement.

An injury or sickness may leave a person unable to work for days, months, years, or for the balance of his or her life. Basically, when an active business owner is disabled for a period in excess of one year (more or less, depending on the business), the disability, whether “temporary” or “permanent” for medical purposes, will affect the business as if it were permanent. Business considerations will usually dictate the replacement of an unproductive and disabled individual; meanwhile, the disabled owner needs the assurance that he or she will receive fair payment for his or her business interest. A disability buy-out agreement funded with disability income insurance is a logical solution.

The success of a disability buy-out agreement may be largely dependent on the insurance used to fund it. Thus, the most logical definition of disability to use in the agreement is likely to be the definition contained in the insurance policy that will fund the buy-out. This places upon the insurance company the burden of determining whether the owner’s disability meets the policy’s definition, thus avoiding potential disagreements among the owners.

Policies may define total disability as the inability to perform the duties of the insured’s regular occupation or a reasonable occupation based on the insured’s education, training or experience. The individual’s ability to contribute in a meaningful way to the business is what you want to insure for the purposes of a disability buy-sell agreement. Even if the owner can work in a different, unrelated business, he
or she will want to continue to be deemed totally disabled for purposes of the buy-out and coverage under the policy because of his or her inability to work in the former business.

**Taxation of Disability Benefits**

Whether the disability buy-out arrangement is structured as an entity, cross-purchase or trustee cross-purchase agreement, the taxation of premiums and benefits is the same. The premiums paid are not tax-deductible but the benefits are generally received income tax-free.

**Taxation of a Disability Buy-Out**

The actual purchase of the business interest is likely to have income tax ramifications for both the buyer and seller. When the buy-out is between a corporate entity and a disabled owner and the transaction qualifies as a complete redemption of a shareholder’s stock, the payments received generally will be treated as a capital gain or loss. If the buy-out is a cross-purchase between the shareholder-employees, it will also be considered a capital transaction and taxed accordingly. The disabled owner is taxed only on the gain from the sale of the business interest.

When the buy-out is between a partnership and a disabled partner and results in a termination of the disabled partner’s interest, it is taxed as a liquidation of his or her interest. Where the buy-out is a cross-purchase between partners, it is taxed as a sale of the partner’s interest.

If any buy-out payment is made after the close of the tax year from the date the buy-out occurs, the sale will be considered an installment sale, unless the seller elects out of the installment method. Under the installment method, a proportionate amount of the overall gain realized is reportable and taxable each year the disabled owner receives installment payments. Unless an adequate interest rate is charged for deferred payments, a portion of each installment payment will be converted to interest income.

If the business is a C Corporation, disability policy benefits paid to the corporation under an entity purchase agreement could trigger the Alternative Minimum Tax (AMT). When the company receives disability insurance proceeds, the amount received will increase an existing AMT liability or create a new exposure to the (very complicated) tax. If the business is subject to additional tax as a result of receiving disability proceeds, there will be less cash available to execute the buy-out.

**The Use of a Trustee**

No matter how harmonious the relationship of the owners may be while all the owners are healthy and active in the business, the disability of an owner may cause the remaining owners and the disabled owner (or members of his or her family) to have differences of opinion as to their respective rights. The active owners may be concerned whether the disabled owner will sell his or her share of the business. The disabled owner may be concerned whether the active owners will do everything they can to make sure the sale is completed at the agreed price. These concerns may be alleviated when a trustee is used.

Often, a trustee is utilized to guarantee performance of the obligations under a buy-out agreement. The trustee receives the proceeds from the insurance company and executes the transfers in accordance with the terms of the agreement. The trustee serves several important purposes:

- The trustee receives the benefits and holds them in a separate interest-bearing account.
- The trustee is authorized to pay this money only when the buy-out has taken place according to the agreement.
• The disabled owner is assured that purchase money is available when the time comes to sell.
• The healthy owner(s) is assured that the money needed to buy the disabled owner’s business share is available.

The Waiting Period Prior to Purchase
During the early stages of the business owner’s total disability, both the owner and the owner’s business associates may expect that the owner will recover and return to work. As a matter of fact, in most cases, total disability is determined only after the injured or sick individual has been incapacitated for some period of time. Therefore, it is necessary to establish a definite time after disability first occurs when the buy-sell obligation will be triggered, thereby assuring that the disabled owner’s interest will not be purchased until after the owner’s recovery and return to the business is unlikely.

Obviously, the appropriate period before the ownership interest should be purchased under the agreement can and will vary from case to case. In determining an appropriate waiting period, consideration should be given to a variety of factors, including:

1 | What means of support will the business owner have during this period?
2 | How long can the business continue to pay part or all of the disabled business owner’s salary?
3 | Is the disabled owner the beneficiary of an accident and sickness plan for employees, which will provide an income during the waiting period?
4 | Considering the nature of the business, how long will it take for the owner to become “out-of-touch” with the affairs of the business upon a prolonged disability?

This last consideration can be especially important in establishing an appropriate interim period between the time when an active owner becomes disabled and the time for sale of the disabled owner’s business interest under the terms of the agreement. Once an owner sells an interest in a business because of his or her disability, they should not later have the prerogative of regaining their former position in the business solely because the owner recovers from the disability.

Some authorities recommend that the buy-sell obligation be drafted as mandatory on parties after the expiration of the waiting period. A return to work after a prolonged disability may not be acceptable to those who remain active in the business. Therefore, serious thought must be given to the choice of the waiting period. If the business owner recovers from the disability before the end of the period, he or she will resume whatever duties were performed in the business. However, if their interest is purchased under the agreement because the disability outlasts the period selected and later they recover, resumption of an active role in the business by the former owner should not be a matter of right. It should take place only if it is considered acceptable to all of the parties involved under the circumstances then existing in the business.
Paying the Purchase Price

Disability income insurance policies contain a waiting period before benefits are paid (the elimination period). Disability buy-out policies typically come with a choice of three elimination periods: 12 months, 18 months, or 24 months. At the end of the elimination period, the policy pays the benefit in either a lump sum, installment payments, or a combination of the two. Whether the satisfaction of the policy’s elimination period triggers the buy-out agreement will depend on the terms of the buy-sell agreement.

If the policy provides for a lump-sum payment in an amount sufficient to buy the disabled owner’s business interest, the purchase date will almost always coincide with the end of the elimination period.

If the lump-sum payment is in an amount that is less than the full purchase price, or if the policy provides for installment payments, then the buy-out will be structured as an installment sale. Under either circumstance, the parties must consider coordination of the waiting period before purchase and the elimination period under the policy. For example, the buy-sell agreement may provide that the buy-out shall occur at the end of the elimination period. On the other hand, the agreement may provide for a six-month waiting period before purchase, while the funding policy has a 12-month elimination period. Here, the buyers should have sufficient cash on hand to handle the initial payments under the installment sale obligation as outlined in the buy-sell agreement. Once the buy-out is triggered, the seller relinquishes all control over the operation of the business organization, although he or she may retain a collateral interest in the business interest to secure payments under the installment sale. Payments will continue regardless of whether the insured has recovered or not.

What might be a desirable elimination period in one case may be too short or too long in another. In a small business, the loss of one owner’s services might be felt more severely than in a large business where responsibilities might be reallocated with relative ease. Bearing in mind that the shorter the elimination period the more costly the coverage, it is up to the parties to decide what is a reasonable length of time to wait before payments (and the buy-out) begin.

Additionally, the parties must contemplate what happens during the buy-out period if the insured recovers, and benefits payable under the policy stop. If, at the buy-out trigger point, the insurer makes a payment to the purchasers in a lump sum, then the transaction may be immediate and complete. However, if the buy-out benefits are to be paid in installments (e.g., over a five-year period), should the insured recover (or die) during this time, benefit payments may terminate completely although the buy-out must continue according to the terms of the legally binding agreement. Often, if the seller dies during the installment period, the remaining unpaid balance is accelerated. This contemplates the availability of death proceeds from a policy insuring the life of the seller.
Valuation

One of the key provisions in a disability buy-out is how and when the business is to be valued. The value of the business is usually established by a formula based on net worth, capitalization of earnings, or a combination of these and possibly other factors.

There are generally two dates which can be used for establishing the value of the business. These are:

• the date the owner first becomes disabled, or
• the purchase date of the buy-out.

The date the owner first becomes disabled is often favored because the disabled owner will not suffer from a decline in the value of the business due to his or her extended absence.

In establishing a method for valuing the business, the attorneys and accountants for the company should be involved and will often help the owners make decisions as to how the buy-out price is to be established.

Benefits of a Disability Buy-Out Agreement

The benefits of a well-crafted and properly funded disability buy-out agreement can be summarized as follows:

Benefits to the Active Business Owners

• They acquire the business interest of the disabled owner at a fair price.
• They maintain ownership and control.
• Benefits are received tax-free.
• There is a smooth transition of ownership.
• Third party decides when the definition of total disability is met.

Benefits to the Disabled Business Owner

• He or she receives the funds necessary to purchase the business interest.
• He or she does not need to worry about future business fluctuations, including losses.
• He or she is taxed only on the gain from the sale of the business.

Benefits to the Business

• Full funding is available when needed.
• Benefits are received tax-free.
• No interest charges.
• No lien, credit restriction, or drain on profits.
Business Overhead Expense Insurance

As stated in the overview, “Don’t forget DI” in your business succession planning. One should also never “Rule Out” business overhead expense in such planning. Consideration should always be given to business overhead expense (BOE) insurance because a disability may not be forever, but the damage done by the absence of an owner to the value of a business can be. BOE insurance is designed to reimburse a business for overhead expenses in the event a business owner becomes disabled. This should not be confused with individual disability insurance because BOE is not the same as personal disability insurance which usually pays benefits to age 65. A business overhead expense policy pays a shorter benefit of one to two years after an elimination or waiting period. This insurance is designed to cover the operating expenses of a business if the owner of the business has become totally or partially (depending on the structure of the policy) disabled. The coverage differs from an individual disability policy in that it covers business expenses. Since business expenses are not part of the owner’s salary, the BOE insurance policy is needed to pay these expenses until the owner can return to work or sell the business interest.

The BOE insurance policy covers a variety of operating expenses including:

- General office supplies;
- Employee salaries;
- Employment taxes;
- Rental payments for property;
- Equipment;
- Mortgage;
- Utilities;
- Accounting;
- Legal fees;
- Interest on business debts; and
- Property taxes.

See business overhead expense checklist on the next page for a complete list of expenses.

The Benefits:

The benefit to the business is that there is a strategy in place to help ensure that the business continues to survive in the event of disability. This protection may potentially increase the business’ credit rating.

The benefit to the owner is the peace of mind that suppliers, vendors, salaries, rent or lessors will be paid on time. Employees will also continue to be paid during the period of disability.

The Tax Considerations:

The cost (premiums) paid by the business are tax deductible. However, the benefits are taxable when the policy proceeds are paid at disability. Since the proceeds are used to pay business costs, they are generally tax deductible.
## Business overhead expense checklist

### Business expense tool

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
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<tbody>
<tr>
<td><strong>Rent/Mortgage expenses:</strong></td>
<td></td>
</tr>
<tr>
<td>- Rent</td>
<td></td>
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<tr>
<td>- Property tax (if allowable)</td>
<td></td>
</tr>
<tr>
<td>- Mortgage interest payment</td>
<td></td>
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<tr>
<td><strong>Utilities:</strong></td>
<td></td>
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<tr>
<td>- Electricity/lights</td>
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<tr>
<td>- Gas/heat</td>
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<td>- Water</td>
<td></td>
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<td><strong>Real estate tax:</strong></td>
<td></td>
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<tr>
<td><strong>Professional fees:</strong></td>
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<tr>
<td>- Accountant fees</td>
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<td>- Collection agency fees</td>
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<td>- Legal fees</td>
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<td><strong>Insurances:</strong></td>
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<tr>
<td>- Malpractice</td>
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<td>- Property/casualty</td>
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<tr>
<td><strong>Dues:</strong></td>
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<tr>
<td>- Professional societies</td>
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<tr>
<td>- Professional licenses</td>
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<tr>
<td><strong>Business subscriptions:</strong></td>
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<tr>
<td>- Muzak</td>
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<td>- Prof. newsletter and magazine subscriptions</td>
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<th>Item</th>
<th>Amount</th>
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<tr>
<td><strong>Interest on business loans:</strong></td>
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<td><strong>Telephone:</strong></td>
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<tr>
<td>- Telephone bill</td>
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<td>- Answering service</td>
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<td><strong>Employee expenses:</strong></td>
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<td>- Employee salaries</td>
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<tr>
<td>- Payroll taxes</td>
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<td>- Employee benefits</td>
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<td>- Employee pension</td>
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<td><strong>Costs of leasing:</strong></td>
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<tr>
<td>- Equipment</td>
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<tr>
<td>- Car rental fees</td>
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<tr>
<td><strong>Depreciation:</strong></td>
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<td>(use principal payment if greater)</td>
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<tr>
<td>- Building</td>
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<td>- Equipment</td>
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<tr>
<td><strong>Maintenance services:</strong></td>
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<td><strong>Other:</strong></td>
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<tr>
<td>- Advertising</td>
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<td>- Computer supplies and expenses</td>
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<td>- Office supplies and expenses</td>
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<td>- Laundry</td>
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<td>- Postage</td>
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<td>- Billing costs</td>
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Subtotal: $________

Grand total: $________

State at business ownership percent: $________

Professional replacement expense: $________
SPECIMEN DISABILITY BUY-OUT AGREEMENT

This specimen agreement has been produced for illustrative purposes only. Legal Counsel is solely responsible for preparing the actual document to be used.

THIS SUPPLEMENTAL AGREEMENT made this _____ day of _____________, 20_____, by and between _____________, the Business Organization, and __________________ and ___________________, the Business Owners.

WHEREAS, the Business Owners wish to provide certain monthly disability benefits to any business owner who may become disabled; and

WHEREAS, the Business Owners wish to provide for the purchase and sale of a business owner’s interest in the business organization in the event of his disability.

NOW THEREFORE, in consideration of the mutual benefits and covenants contained herein, the parties agree as follows:

ARTICLE 1: TYPE OF BUY-OUT.

Elect one:

1.01. Entity Purchase. The business organization, hereinafter referred to as the purchaser, shall purchase, in accordance with this Agreement, the complete ownership interest of a totally disabled business owner, hereinafter referred to as the seller, for the value of the ownership interest, hereinafter referred to as the business value, and the seller shall convey all such ownership interest to the purchaser.

1.02. Cross Purchase. The non-disabled business owner(s), hereinafter referred to as the purchaser(s), shall purchase, in accordance with this Agreement, the complete ownership interest of a totally disabled business owner, hereinafter referred to as the seller, for the value of the ownership interest, hereinafter referred to as the business value. If more than one purchaser exists, each purchaser shall purchase that portion of the seller’s business interest as his ownership interest in the business organization would be if the seller’s interest did not exist. The seller shall convey all such ownership interest to the purchaser(s).

ARTICLE 2: BUSINESS VALUE.

Elect one:

2.01. Stated Value. Unless and until changed as set forth herein, the total business value of the entire business organization shall be $__________. The seller’s percentage of ownership shall be applied to this value to determine the price to be paid by the purchaser(s).

On or about the first day of the month of __________ in each calendar year thereafter the business owner(s) will in writing either reaffirm the business value or agree upon a new business value. Copies of this reaffirmation or revision shall be given to all business owners and shall be part of this Agreement.

If the business owners do not reaffirm or agree upon a new value, their failure to do so will not void this Agreement. However, the last value agreed upon by the parties in writing shall be fully binding upon them, except that if the parties do not so reaffirm or agree for three (3) consecutive years, the value shall be determined by the independent Certified Public Account regularly retained by the business organization to audit its books. If no such accountant is available, the value shall be determined by any other Certified Public Accountant selected by the mutual agreement of the parties and his compensation shall be charged equally to each of the parties.

2.02. Formula. [Insert formula.]

2.03. For the purposes of this Agreement, the business value shall be the value determined in accordance with this article during the calendar year immediately preceding the date on which the purchase must take place.

ARTICLE 3: DISABILITY DEFINED AND PURCHASE DATE OF BUY-OUT.

3.01. The purchaser(s) shall purchase the seller’s entire ownership interest in the business organization when the seller has been continuously totally disabled for a period of [elect one]: _____12 months; _____18 months; _____ 24 months.

The date this purchase takes place shall hereinafter be referred to as the purchase date.
3.02. Wherever the term “total disability” appears in this Agreement it shall mean total disability as defined in the Disability Buy-Out Policy(ies) specified in the attached schedule.

ARTICLE 4: TRANSFER OF BUSINESS INTEREST.

4.01. Within 60 days of the purchase date, the purchaser(s) shall deliver the payment for the seller’s business interest to the seller and the seller shall transfer full and complete title of said interest to the purchaser(s).

ARTICLE 5: VOLUNTARY AND/OR INVOLUNTARY TRANSFER OF BUSINESS INTEREST.

Elect one:

5.01. If any business owner who is party to this Agreement should voluntarily desire to dispose of any portion of his respective ownership interest in the business organization during his lifetime or be required to involuntarily transfer any portion of his ownership interest in the business organization, he shall first offer in writing to sell his entire ownership interest in the business organization to the other purchasers who are party to this Agreement. The offer shall be based on a price determined in accordance with the provisions of Article 2 hereof.

Such offer to the other purchasers shall permit each such purchaser to purchase such portion of the ownership interest offered for sale as the percentage owned by the purchaser at the date the ownership interest is offered, excluding the portion offered by the offering business owner. However, if any purchaser does not purchase his full proportionate share of the offered ownership interest, the other purchasers, first on a proportionate basis, then to any willing purchaser, may purchase the unaccepted portion.

If the offer is not accepted by the other purchasers within sixty days of receipt thereof, the offering business owner shall have the right to sell his respective ownership interest to any other person but shall not sell it without giving the remaining purchasers the right to purchase such ownership interest at a price and on the terms offered by such other person. If the remaining purchasers do not accept this subsequent offer within thirty days of receipt thereof, the offering business owner may sell his ownership interest to anyone free of any restrictions contained in this Agreement.

5.02. No business owner who is a party to this Agreement shall, during his lifetime, assign, encumber or dispose of any portion of his respective ownership interest in the business organization by sale or otherwise, voluntarily or involuntarily, without the written consent of all the other purchasers who are parties to this Agreement.

ARTICLE 6: DELIVERY OF PAYMENT METHOD.

Elect one:

6.01. Full Payment of Purchase Price. The purchaser(s) shall deliver to the seller the full and complete amount of the business value in cash.

6.02. Installment Purchase. The purchaser(s) shall deliver to the seller an initial payment equal to _____% of the business value. The balance due on any purchase shall be paid in _____(#) equal quarterly, semi-annual, annual [elect one] installments, with interest on the unpaid balance computed at the applicable federal rate specified by IRC § 1274(d) compounded annually. In the event of default in payment of any installment for a period of 90 days, any remaining unpaid balance shall become due and payable at the election of the holder.

6.03. The death of the seller during the installment period shall cause any remaining unpaid balance relating to this Agreement to become due within 60 days of the seller’s death.

ARTICLE 7: DISPOSITION OF LIFE INSURANCE POLICY(IES).

7.01. If a Buy-Out Agreement for purposes of purchasing a deceased owner’s interest exists, funded by life insurance, the seller shall have the right to purchase such policy(ies) insuring the seller’s life from the purchaser(s). This right must be exercised within 90 days after the purchase date of the disability Buy-Out.

7.02. The purchase price shall be equal to the cash value of such policy(ies) including dividends if any less any indebtedness secured by the cash value on the date of purchase by the seller. The value shall be as determined by the insurance company issuing the policy(ies).
ARTICLE 8: CONTROL OF BUSINESS ORGANIZATION DURING DISABILITY.

In the event a business owner is totally disabled for a continuous period of six (6) months he shall [elect one]:

8.01. Relinquish all control over the operation of the business organization to the remaining business owner(s). They shall then exercise complete control of the business organization, in accordance with their percentage of ownership therein, calculated as if the ownership interest of the disabled business owner did not exist, until such time as the business owner is no longer totally disabled or until the purchase date of this Agreement, whichever occurs first.

8.02. Retain control over the operation of the business organization in accordance with his ownership interest until the purchase date of this Agreement.

ARTICLE 9: INSURANCE POLICIES AND LIABILITY OF INSURER.

9.01. The purchaser may acquire disability income buy-sell insurance on each business owner to fund this Agreement. The insurance policies shall be indicated in the schedule attached to this Agreement. The business owners shall cooperate in obtaining the insurance, including taking medical exams and providing underwriting information to the insurance company.

9.02. The insurance company shall have no liability under this Agreement except as set forth in the policy itself, and is not bound to inquire into the terms of this Agreement. Payment or other performance of its contractual obligations in accordance with the terms of the policy shall completely discharge the insurance company of any claims, responsibilities or liabilities hereunder.

ARTICLE 10: MISCELLANEOUS.

10.01. All fringe benefits (including salary continuation) covering a disabled business owner as an employee of the business organization shall continue in force during the continuance of disability under the terms outlined in the respective fringe benefit plans.

10.02. This Agreement shall be binding on the parties, their heirs, legal representatives, successors and assigns.

10.03. This Agreement may be terminated or amended by written agreement of all parties hereto. It shall terminate automatically upon the dissolution or bankruptcy of the business organization.

10.04. The laws of the State/Commonwealth of ______________ shall govern this Agreement.

IN WITNESS WHEREOF, the parties have signed this Agreement on the date above indicated.

______________________________________________
Business Organization

______________________________________________
Business Owner

______________________________________________
Business Owner

In Community Property states the spouses of the business owners should also sign as parties to acknowledge the Agreement and bind their community property interests.
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