LifePlan
For your business®

DESIGN OPTIMAL SOLUTIONS

Selling to Co-Owners

Business Owner Exit Options - Selling to Co-Owners

Selling the business to co-owners is a viable option when no other market for the business exists. Selling to co-owners may also be a long-term plan that is organized through a buy/sell agreement.

Advantages of Selling to Co-Owners

- The co-owners may provide an easy buyer for a business that would otherwise be difficult to sell.
- The business will continue in existence and will be run by owners who already have knowledge of the business, thus increasing the likelihood of the business's ongoing success.
- There may be a buy/sell agreement in place between co-owners which would likely define the purchase price, thus removing the need to negotiate the price.

Disadvantages of Selling to Co-Owners

- An agreement between co-owners may result in the selling owner providing some form of financing for the purchase of the business (i.e., a promissory note).
- If no buy/sell agreement is in place, co-owners may have a difficult time negotiating a purchase price and terms, partially due to varying thoughts on the value that the departing owner adds to the business.

In General

Selling to co-owners will consist of a negotiation between the two parties. To the extent the negotiations take place before the time the stock is to be transferred, a buy/sell agreement should be executed to formalize the rights and obligations of each party and to mitigate risk for all parties.

Selling to Co-Owners without a Buy/Sell Agreement

In situations where the exit of a business was not planned, one option is to sell to co-owners at an agreed upon purchase price and terms. When a business owner is in a situation where he or she wants to get out of the business, it is often due to an event that leaves the selling owner in a position with little leverage. Failing to have a buy/sell agreement in place may create a difficult negotiation process.

Selling to Co-Owners with a Buy/Sell Agreement

A purchase by co-owners may create a market for a business interest that would not have otherwise been present. When selling to co-owners, a buy/sell agreement should be executed to explain how the owners will determine the value of the business and the terms of the sale. Having an agreement explaining how the business will be valued removes a difficult step in the process at the time of the sale. Further, many buy/sell agreements include stipulations such as a right of first refusal to protect the owners who are not selling. A right of first refusal gives the owners the option to purchase a selling owner's interest before a third party can purchase the interest. Having a buy/sell agreement in place is strongly suggested for all owners to remove some of the risk in owning a fractional business interest.

Tax Treatment

Generally, if co-owners purchase the remaining business interest, the sale is structured as a stock/equity sale.

Corporation

If the selling owner sells his or her stock, the owner will recognize gain or loss to the extent the amount received exceeds the owner's basis in the corporation. Gain will generally be taxed at capital gains rates.

Partnership/LLC

If the selling owner sells his or her equity, the owner will recognize gain or loss to the extent the amount received exceeds the owner's basis in the partnership/LLC. Generally, the gain upon the disposition of partnership/LLC interests will be taxed at capital gains rates; however, an exception to this rule exists with respect to gain attributable to unrealized receivables and inventory.

Process of Selling to Co-Owners

- For a sale to co-owners through a pre-negotiated arrangement, a buy/sell agreement will be executed. The purchase price and terms will be stipulated in the agreement. Depending on the terms of the buy/sell agreement, a valuation may be needed to determine the fair market value of the business interest being purchased. The terms of the purchase may include a promissory note with payments stretched over a period of time with an appropriate interest rate being applied.
- For a sale to co-owners without a buy/sell agreement, both parties must agree to a purchase price and terms at the time of the purchase. A valuation may be appropriate to determine the fair market value of the business. The co-owners may purchase the selling owner's interest with a promissory note or may agree upon one lump sum payment. If using a note, it may be structured to pay the purchase price over time and would likely include an appropriate rate of interest.