Buy-Sell Review

Plan for the future of your business.

Presented to

Presented by

Taking steps now to protect the future of your business is important. That's why having a buy-sell agreement in place is such a good idea. We appreciate the opportunity to look at your current plan and hope that this Buy-Sell Review ("Review") will be helpful to you as you continue your planning.

We received the following documents for ("Company"):

- Document Name, dated MM/DD/YYYY, ("Agreement")

- Business Planning Fact Finder

- None from 2023 to 2025

Important information

Please note this Review is based on our review of these documents and is intended to be used as a basis for discussions with your tax and legal advisors. If these documents are invalid in any way or other pertinent documents exist that we're not aware of, the observations, recommendations and analysis contained in this Review may be inaccurate. Principal® does not provide tax or legal advice.

This Review does not provide you with a legal opinion as to the legal or tax implications of your agreement or the appropriateness of any funding strategies. Principal cannot provide you with any legal document or revise existing legal documents. If an informal valuation is provided, it is not a substitute for a formal valuation, nor does it establish a value for tax purposes. The Review is intended to help identify your objectives for the buy-sell agreement and any issues that must be addressed to help ensure your objectives are being met.

Some Agreements include language that structures the financial and working relationship among co-owners of the business, with buy-sell provisions being only a part of the entire agreement. This Buy-Sell Review is limited to only the buy-sell provisions found in the Agreement.

Prepared by: Advanced Solutions Reviewer
Reviewed by: Advanced Solutions Reviewer

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Background information

Entity type	S corporation
Entity taxation	S corporation
Type of agreement	business continuation limited liability company
Business owners	

Comments:

- An S corporation is generally a pass-through entity for income tax purposes.
- The owners are urged to follow the procedures outlined in the Agreement closely. Ignoring valuation and other procedures dictated by the Agreement could undermine the validity of the Agreement.
- The Company's ownership may have experienced some changes since the Agreement was created. Now may be a good time to update the Agreement so that the appropriate parties are named as owners and bound to the provisions of the Agreement.

Executive summary

Our goal in providing this Review is to help you make sure that if interests in this business should need to be sold or transferred you have:

- enough funds
- in the right place
- at the right time

Highlights of your Agreement:

- Death - In the event of a business owner's death, the Agreement is structured as a business continuation limited liability company buy-sell arrangement. The buy-out at death is mandatory.

- Disability - In the event of a disability, the purchase of an owner's interest is mandatory. The definition of "disability" for purposes of the buy-sell does not align with the definition in a disability buy-out policy.

- Purchase Price - The Agreement states that the price for a business owner's interest at death will be based on an periodic determination that may be out of date.
- Purchase Price - The Agreement does not address what the price will be for a business owner's interest at death.
- Purchase Price - The provision of the Agreement intended to specify an agreed purchase price is blank.
  - We completed an informal business valuation of the Company based on Company financials. Using several formulas (but excluding book value), the business value ranged from $ to $. The Highlighted Value in the Informal Business Valuation is $.
  - Consider the impact to the business of installment payments to buy the interest of a deceased or disabled owner. For example, the cost of purchasing a $1,000,000 business holding over 5 years is $200,000 per year (not factoring interest). Given that the buyer is generally using after-tax dollars to purchase, the cost is approximately $317,460 per year when factoring taxes at 37%.

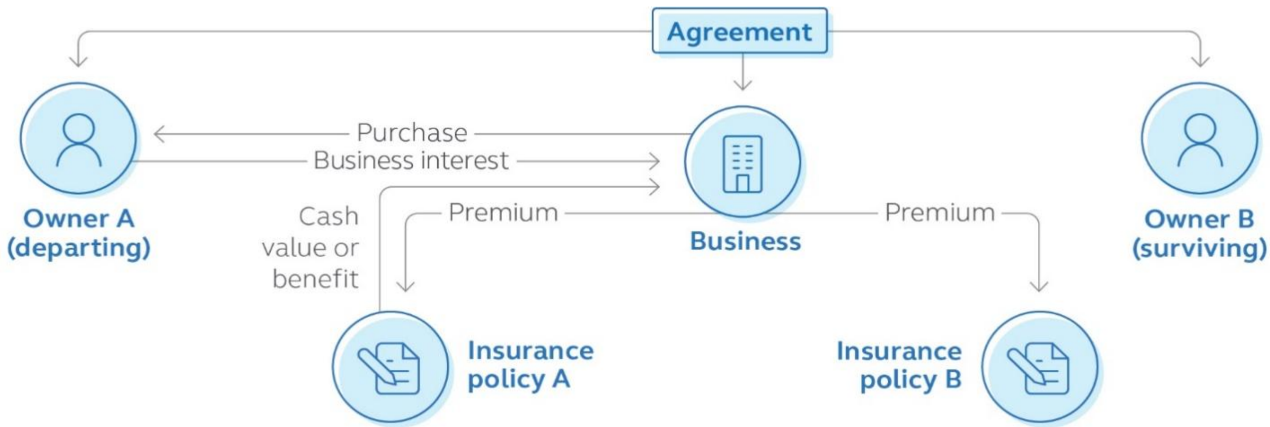
- Life Insurance paid to a company - The U.S. Supreme Court in *Connelly v. US* (2024) held that if the buy-sell agreement does not successfully lock-in a value for estate tax purposes, life insurance paid to a company generally increases the value of the company for estate tax purposes, with no offset for the redemption obligation. If any owner anticipates being subject to the Federal estate tax, the owners might wish to reconsider the buy-sell design. Alternatively, additional life insurance (likely owned in an irrevocable trust) may be needed to provide liquidity to pay any estate tax that may be due.

- Priority considerations:

- Action items:
  - Review and update (if needed) any life and disability buy-out coverage related to this Agreement.
  - Discuss this report with your tax and legal advisors.

Your agreement structure:
Entity purchase

The Agreement is drafted as an entity purchase buy-sell arrangement upon the death of a business owner. Under this entity purchase buy-sell plan design, the business entity, as opposed to the surviving business owners, is the purchaser of a deceased owner's interest.



Comments:

- An entity purchase buy-sell arrangement provides the simplicity of only one life insurance and/or disability buy-out policy on each business owner. This may be an advantage over a cross purchase buy-sell design when there are multiple business owners.

- Under an entity purchase arrangement, life insurance policies are owned by the business entity, and the policy owner is also the beneficiary. Entity-owned policies would be subject to the claims of creditors of the business. However, the policies would not be subject to the claims of personal creditors of the business owners.

- If company-owned life insurance will be used to provide funding for the Agreement, it is important the Agreement explicitly state how the cash values and death benefits will be treated in the valuation of the company, and that the valuation procedures dictated by the Agreement be followed closely.

- The U.S. Supreme Court in *Connelly v. US* (2024) held that if the buy-sell agreement does not successfully lock-in a value for estate tax purposes, life insurance paid to a company generally increases the value of the company for estate tax purposes, with no offset for the redemption obligation. If any owner anticipates being subject to the Federal estate tax, the owners might wish to reconsider the buy-sell design. Alternatively, additional life insurance (likely owned in an irrevocable trust) may be needed to provide liquidity to pay any estate tax that may be due.

Your agreement structure:

Entity purchase

Additional comments:

- Your tax and legal advisors may provide you with a full list of advantages and disadvantages of the different types of buy-sell arrangements.

- Most states have laws that address the conditions under which a corporate redemption may occur. Often, these statutes relate to the level of corporate surplus present at the time a stock redemption is to occur. Since the timing of a stock redemption may be unpredictable, life and disability insurance contracts may be helpful to the business owners in facilitating the redemption.

- The implementation of an entity purchase arrangement can result in an unintended shift of control upon the death of one owner. Business owners should discuss with legal counsel whether an entity purchase will meet the owners' goals under varying scenarios.

Additional information

The business owners might wish to discuss the following with local counsel:

- THIS PAGE IS USED BY ATTORNEYS TO ENTER CUSTOM COMMENTS.

Purchase and sale events

The following summarizes typical purchase and sale triggering events and indicates whether they are addressed in your buy-sell agreement:

Triggering events	Mandatory/optional	Purchasers
Death	mandatory	company optional company 2nd mandatory
Disability	mandatory	company mandatory company 2nd mandatory
Retirement	not addressed	not addressed
Termination of employment (voluntary)	not addressed	not addressed
Termination of employment (involuntary)	optional	company optional
Bankruptcy	optional	company optional
Divorce	not addressed	not addressed
Operation of law	not addressed	not addressed
Loss of professional license	not applicable	not applicable
Deadlock provision	not applicable	
Tag-along rights and/or drag-along rights	neither	

Purchase and sale events

Comments:

- Purchase rights or options arising from the occurrence of buy-sell event triggers are typically subject to time limits. If a potential buy-sell triggering event occurs, the parties should pay close attention to the time limit provided to exercise a purchase right or option.

- Including death as a mandatory buy-sell provision for buyer and seller is common in buy-sell agreements.

- Including disability as a mandatory buy-sell provision for buyer and seller is common in buy-sell agreements.

- Personal bankruptcy of a business owner, or other assignment of the business interest to creditors, is often a buy-sell triggering event. Review with local counsel whether personal bankruptcy, or assignment of the business interest to creditors, should be a mandatory or optional triggering event.

- The divorce of a business owner is often a buy-sell trigger if the spouse of a business owner is awarded an ownership interest in the Company pursuant to the divorce. Often the divorcing business owner is provided the initial option to purchase. The Company and other business owners may be given secondary purchase options. The parties may wish to consider adding divorce as a buy-sell triggering event.

- Termination of employment for any reason other than one of the enumerated event triggers, whether voluntary or involuntary, is often a buy-sell triggering event. Consider the advantages and disadvantages of including termination of employment as a purchase option.

- Retirement is an important mandatory triggering event often overlooked under a buy-sell agreement. Consider amending the Agreement to include retirement of a business owner as a mandatory purchase event.

Purchase and sale events

Additional comments:

- Discuss with local counsel which buy-sell triggering events should be mandatory and which ones should be optional.

- Loss of professional license is often a buy-sell triggering event for specific industries. If the business is a professional practice, discuss with local counsel the buy-sell procedures if a business owner loses his or her license for minimum specified period of time.

- Generally under 'drag-along' provisions, if a majority owner sells his or her interest, the majority owner is provided a 'call' option to force minority owners to also sell their interests, generally upon the same terms afforded to the majority owner.

- Under a typical 'tag-along' provision, if a majority owner sells his or her interest, the minority owners are granted a 'put' option, which they may exercise to require the purchaser to also purchase their interest, generally upon the same terms afforded to the majority owner.

- A deadlock provision may be helpful to avoid irreconcilable differences between owners. It is most often included in buy-sell agreements where there are only two business owners. Under this provision, a business owner who receives a purchase offer from a co-owner must either sell to the co-owner, or purchase the co-owner's interest at the price and terms contained in the offer.

- As the Agreement is currently structured, it's possible that there may be a determination of disability under the Agreement's provisions, but the insurer from whom disability insurance policies have been acquired might not agree. This potential conflict between disability funding and the Agreement's disability provisions may create a cash flow shortage for the purchaser. Generally, when a disability trigger is included and funded in an Agreement, the Agreement incorporates by reference the disability buyout insurance company's definition of 'disability' for its purposes. Review this important matter with local counsel.

S corporation considerations

Comments:

- All outstanding shares of S corporation stock must confer identical rights to distribution and liquidation to shareholders pro-rata according to their stock ownership. If identical rights to distribution and liquidation proceeds are not conferred pro-rata according to stock ownership, an impermissible second class of stock may result, which could cause a termination of the S corporation election. Review with local counsel any provision in the Agreement that may create an impermissible second class of stock. Discuss this matter with local counsel.

Purchase price

In the events of death and disability, the purchase price of a business owner's interest is a pro rata portion of the value of the Company determined as indicated below.

Purchase price provisions	Death	Disability
Primary method of determining the purchase price	based on an periodic determination that may be out of date	not addressed
Second method of determining the purchase price (if applicable)	not addressed	not addressed
Third method of determining the the purchase price (if applicable)	not addressed	not addressed
Does agreement contain language attempting to exclude insurance death benefits from the business value?	no	

Other provisions		
Does the Agreement provide for marketability, lack of control, or minority interest discounts?	Agreement requires discounting	
For certain triggering events, is the purchase price subject to a "haircut"?	no	
Did Principal prepare an informal business valuation?	yes	

Comments:

- The purchase price for other triggering events in your agreement may differ.
- We completed an informal business valuation of the Company based on Company financials. Using several formulas (but excluding book value), the business value ranged from $ to $. The Highlighted Value in the Informal Business Valuation is $.
- The Supreme Court ruling in *Connelly v. US* (2024) makes it unclear whether an agreement can successfully set a business value for estate tax purposes that excludes life insurance death proceeds. See the "Life insurance paid to a company" page for an overview of how company-owned life insurance may impact the value of the company for estate tax purposes.
- Note that disability buyout coverage from Principal is designed to reimburse the business for covered expenses after the buyout obligation has been incurred. While unlikely, it is unclear whether a disability buyout insurance benefit paid to a company would have the same effect as life insurance proceeds on the estate tax value of the insured's business interest under Connelly - particularly if the disabled owner survives until long after the buyout. The business owners are encouraged to discuss this issue with their own legal and tax counsel.

Purchase price

Additional comments:

- The valuation provisions of buy-sell agreements are among one of the most frequently litigated issues in buy-sell disputes. Courts tend to hold owners to the terms of their contract, even if the outcome is not as fair as the owners expect. Owners need to be cognizant of the standards by which the value of their interest will be determined, and whether the terms of the Agreement will permit a minority owner's share to be reduced because of lack of control and/or marketability. Owners are urged to discuss this issue with local counsel, taking care to be certain they understand the pricing provisions of their agreement. If a buy-sell agreement requires ownership valuation to be determined by an outside appraisal, best practice is to instruct the appraiser in the Agreement whether to apply minority interest or marketability discounts.

- The Agreement requires discounting of the purchase price for circumstances such as lack of control or lack of marketability. It is important to discuss the estate tax implications of this issue with local counsel.

- Key employee life and disability coverage may be helpful to the business owners in protecting the value of the business from the unexpected loss of a key employee's services. Typically, the business is the owner, premium payer, and beneficiary of key employee policies. Policy proceeds may be income tax free, while premium payments are generally non-deductible to the Company.

- Businesses with two or more owners can fully fund their buy-sell Agreement with life and disability buy-out insurance. Review the purchase price provisions of your Agreement and ensure the Agreement is funded with the appropriate amount of insurance.

Purchase terms

Life insurance and disability buy-out coverage may be very helpful in matching cash needs with cash flow.

Purchase term provisions	Death	Disability
Required to apply insurance proceeds towards purchase price	not addressed	not addressed
Method for purchasing a departing owner's interest	not addressed	not addressed
Installment period	not addressed	not addressed
Down payment	not addressed	not addressed
Interest rate	not addressed	not addressed

Comments:

- The purchase terms for other triggering events are not addressed.
- If installment payments are for a period of less than 10 years, the parties may wish to compare the likely cash needs of the Company to cash flow upon the occurrence of a buy-sell trigger. If the cash needs are substantial and cash flow limited, the parties may wish to consider provisions for payments over a longer period of time.
- The agreement should explicitly require use of available life insurance proceeds and disability buy-out proceeds to complete a sale under the Agreement.
- Since installment payments to a business owner may be scheduled beyond the unexpected death of a business owner, it may be advisable for policy owners to retain ownership of any life insurance policies on the life of the selling business owner. As the term of the note nears completion, the policy may be transferred for its fair market value as final payment.

Funding

The ownership and beneficiary structure of life and disability insurance policies acquired for purposes of a buy-sell agreement should be aligned with the Agreement's purchase obligations.

Life insurance on business owners	not discussed
Disability buy-out insurance on business owners	not discussed
Schedule of life and disability policies included	no
Life insurance ownership and beneficiary designations aligned with Agreement	unknown
Disability buy-out ownership and beneficiary designations aligned with Agreement	unknown
Agreement discusses distribution of excess life insurance proceeds	no
Option for business owners to purchase policies when Agreement completed or terminated	no

Comments:

- The parties may wish to review insurance coverage. It's important to periodically update the amount of insurance in force to a level that's roughly consistent with the value of the business. The amount of insurance available to purchase depends upon the value of the business. Underwriting standards for life insurance and disability coverage are different.

- Life insurance death proceeds are income tax free to an employer only if the insurance is properly structured and the employer complies with IRC Section 101(j). Section 101(j) applies to employer-owned life insuance issued or materially changed after August 17, 2006. To preserve the favorable income tax treatment of life insurance death proceeds, Section 101(j) compliance requires written notice and signed consent by the insured employee to the placement of life insurance coverage owned by the employer. In addition, annual information reporting (Form 8925) on employer-owned policies is required by IRC Section 6039I. Cross-owned policies do not appear to be subject to these rules since they are not employer-owned.

Funding

Additional comments:

- Many business owners find it advantageous to list all life and disability insurance policies acquired for purposes of the buy-sell agreement, including ownership and beneficiary arrangements, on a separate schedule attached to the agreement. Where life insurance policies are concerned, this practice has the advantage of not confusing whether death proceeds are to be used for key person needs of the business or to complete the purchase of a deceased owner's business interest.

- If the Agreement includes a disability trigger, or one is added, it may be helpful to review with local counsel whether the disability terms of purchase procedures in the Agreement are consistent with the claims payment procedures in the disability buy-out policy. Some disability buy-out policies may be structured by insurers as expense reimbursement policies. Therefore, a disability buy-out claim may not be payable until the buy-out of a disabled owner's interest has occurred.

- A new owner purchasing the Company on an installment sale basis may find it helpful to acquire business loan protection disability coverage to ensure a source of future payments if the purchaser should become disabled.

- The Agreement does not provide business owners an option to purchase any policies owned by the Company and/or other business owners upon termination or completion of the Agreement.

- The agreement does not address disposition of life insurance policies if the buy-sell ceases to apply to a particular insured while alive. There is somewhat inconsistent authority on the question of whether an insured's right to buy a policy insuring himself/herself from another for fair market value constitutes, in and of itself, an incident of ownership in the policy. As such, the drafting attorney should include such a provision only after reviewing the relevant legal authorities, such as Rev. Rul. 79-46 (right to buy is incident of ownership) and Est. of Smith 73 TC 307 (1979) (right to buy is not incident of ownership).

- Whenever a life insurance policy is transferred from a business to an individual, the fair market value of that policy is generally income taxed. Revenue Procedure 2005-25 provides safe harbor formulas for determining the fair market value of life insurance policies that are transferred from employers to employees, and from qualified retirement plans to participants. Generally speaking, the fair market value of a policy is at least as large as its net cash value, but it can be greater as well. The insurance company that issued the policy is in the appropriate position to provide the measure of fair market value for its products pursuant to the formulas in Revenue Procedure 2005-25. The safe harbor formulas found in Revenue Procedure 2005-25 do not technically apply to transfers of policies between individual business owners, but some practitioners think that the Revenue Procedure 2005-25 formulas should apply in such contexts as well.

Life insurance paid to a company

Whenever life insurance proceeds are paid to a company (most common with entity purchase and wait-and-see buy-sell agreements), the parties will want to discuss with local counsel the effect of the June 2024 US Supreme Court decision in *Connelly v. US* .

Highlights of your agreement:

Concern about value for estate tax purposes?	unknown
Type of agreement	business continuation limited liability company
Primary method of determining the purchase price at death	based on an periodic determination that may be out of date

Per *Connelly v. US* , life insurance proceeds paid to a business entity generally increase the value of the company for estate tax purposes, without an offsetting reduction in value due to the entity's purchase obligation. This in turn generally raises the value of the deceased owner's fractional business interest for estate tax purposes.

Despite *Connelly v. US* , there is reason to think that a buy-sell agreement might be able to set a business value for estate tax purposes that excludes life insurance proceeds payable to the business. In theory, this might be done if the buy-sell agreement contains a value that excludes life insurance proceeds, such value is fixed or derived via formula, and if the agreement also meets certain other criteria. Counsel for the parties involved will have to review the relevant law (IRC Section 2703, Reg. §20.2031-2, and Revenue Ruling 59-60) and their clients' situation to see whether this is a viable approach.

If life insurance proceeds paid to the business do have the effect of raising the value of the business and thus also raising the value of the deceased owner's interest for estate tax purposes, resulting effects could include:

- The decedent's estate being estate taxed on a value that is higher than what is being received as a purchase price under the buy-sell agreement.
- The buyer (likely, the business) potentially having to pay a higher price under the agreement (that takes into account a fraction of the life insurance proceeds), particularly if the purchase price is simply based upon "fair market value" upon death.

To help avoid the issue, the parties might want to instead have any life insurance proceeds paid to the other business owners (rather than paid to the Company), as would be common in a cross-purchase arrangement.

Ultimately, the course of action taken by the parties should be determined only after careful consultation with their own legal and tax counsel.

Transfer restrictions

A provision limiting transfer of ownership interests is common and useful in a buy-sell agreement. Oftentimes, a business owner may not sell, assign, transfer, pledge, dispose of or otherwise encumber any of his or her interest in the Company, except as provided in the Agreement.

The Agreement includes provisions to limit the transfer of ownership	yes
Any transfer of interests in violation of the Agreement will be treated as null and void	not addressed
Transferees are treated as receiving purely an economic interest (non-voting) unless the remaining business owners agree otherwise	no
Permitted transferees include certain family members	not addressed
Permitted transferees include certain trusts for the benefit of family members and/or for estate planning	not addressed
Any transfer that endangers an S corporation election is prohibited	not addressed
Any transfer by operation of law is prohibited under the Agreement	unknown

Comments:

- Transfer restrictions prohibiting the transfer of interests by operation of law often have no binding legal effect.

Right of first refusal

A right of first refusal provision is typically included in buy-sell agreements. Such a provision may be helpful to a business owner wishing to exit the business but may also serve to protect the business owners from being forced to accept an outside party as a new business owner, without recourse.

The Agreement includes a right of first refusal provision	yes
Right of first refusal (1st option)	company optional
Right of first refusal (2nd option)	other owner(s) 2nd optional
Right of first refusal (3rd option)	not included
Option price	not included

Comments:

- A right of first refusal price is generally based on (a) the Agreement price; (b) the third party offer price; or (c) the lesser of the Agreement price or the third party offer price.
- Purchase rights or options arising from the occurrence of a right of first refusal provision are typically subject to time limits. If a right of first refusal is triggered, the parties should pay close attention to the time limit provided to exercise a purchase right or option.

Signatures

It's important that the Agreement is signed by all parties.

Signed by all named business owners	unknown
Company is party to the Agreement	unknown
Signed by a representative of the Company	unknown
Spousal consent provisions included in the Agreement	unknown
Signed by spouses of all business owners	unknown

Comments:

- The inclusion of spousal consent provisions and obtaining the signatures of spouses may be helpful in establishing the value of a divorcing owner's interest in the business. This could also help prevent a divorce court from using its own valuation of the business for marital property settlement purposes.

- Often, a surviving spouse may be named as executor of the estate of a business owner. A smooth transfer of shares at death may be facilitated by prior notice of the Agreement and consent by the surviving spouse.

- The parties may wish to consider adding spousal consent provisions and asking any spouses to sign the Agreement.

Your action plan

The following are discussion points based on the results of this report:

Discussion points	Do I want to make a change?	Priority
The terms of the Agreement if a business owner dies		
The terms of the Agreement if a business owner becomes disabled		
Other buy-sell triggering events		
The Agreement purchase price		
The Agreement purchase terms		
Estate tax exposure		
Structure and adequacy of any life and disability buy-out insurance		

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- Preparer of thousands of informal business valuations since 2011
- Reviewer of more than 3,150 buy-sell agreements since 2014

* 2026 *PLANSPONSOR* NQDC Market Survey, July 2026 (2,606 clients).