

Choosing the Right Continuation Plan for Your Business

The death of a major shareholder in a closely held corporation can seriously interrupt the continuity and profitability of the business. Surviving shareholders must struggle with how to continue the company as a profitable business with the loss of a key player. Heirs must concern themselves with how to replace the income that the shareholder had earned and how to extract their inherited portion of the company value.



To minimize potential areas of conflict and realize a smooth transition, company owners should enter into an agreement while the parties are still living. This is called a buy-sell agreement. Stock purchase plans are generally arrangements through which shareholders agree to sell their stock interests in the event of specific triggering events such as death, disability, or retirement.

Plan Types

Stock purchase plans are generally classified into three categories: stock redemption plans, cross purchase plans, and hybrid plans.

Under a stock redemption plan, the corporation agrees to purchase all or part of the stock interest of a shareholder. There are three approaches to stock redemptions - full redemptions, partial redemptions, and Section 303 redemptions.

In a cross purchase agreement, the remaining shareholders buy the stock interest of a single shareholder. They can either distribute the shares proportionally to what they had before the triggering event occurred or non-proportionally according to what is outlined in the buy-sell agreement.

A hybrid plan, or wait-and-see approach, gives the corporation the first chance to buy. If the corporation does not buy in within a specified time frame (for example, 90 days), the other stockholders have the option to buy. If that option is not exercised, then the corporation must buy the shares.

Factors to Consider

Many factors need to be considered when determining the best type of stock purchase plan to implement, cost factors, psychological factors, ease of administration, tax implications, and transfer for value rules to name a few. You should seek the advice of financial and legal counsel to help implement your plan.

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