



Buy-Sell Review

Summary and Analysis

SAMPLE

Prepared for

Hawkeye Medical Group, P.C.

Sample City, IL

Thank you for requesting a Principal Buy-Sell Review. We have received the following documents:

- Hawkeye Medical Group, P.C. Stock Redemption Agreement dated November 10, 2005 ("Agreement")
- Request for Buy-Sell Review Fact Finder ("Fact Finder")

Please note this Buy-Sell Review (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. To the extent these documents are invalid or other pertinent documents exist of which we are not aware, the observations, recommendations and analysis contained in this Review may be inaccurate. The Principal Financial Group® (The Principal®) does not provide tax or legal advice.

The Buy-Sell 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. The Principal cannot provide you with any legal document or revise existing legal documents. The valuation will not be 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.

Not FDIC or NCUA insured

May lose value • Not a deposit • No bank or credit union guarantee
Not insured by any Federal government agency

Background Information

- Hawkeye Medical Group, P.C. (“Corporation”) is a professional service corporation which has elected to be taxed as an S corporation.
- Parties of the Agreement are John R. Smith, Mary Lisa Brown, and Robert Doe (“Shareholders”) and the Corporation.

Comments and Recommendations:

1. *An S corporation is generally a pass-through entity for income tax purposes.*

General Structure of Agreement

- The Agreement is drafted as an entity purchase buy-sell upon the death of a business owner. Under an entity purchase, the business entity, as opposed to the surviving business owners, is obligated to buy the interest of a deceased owner upon the death of such owner.

Comments and Recommendations:

1. *An entity purchase provides the simplicity of only one life insurance and/or disability buy-out policy on the life of each business owner.*
2. *Under an entity purchase arrangement, life insurance policies are generally owned by the business entity and would be subject to the creditors of the business. However, the policies would not be subject to the personal creditors of the business owners.*
3. *Life insurance death proceeds are only income tax free to an employer if the insurance is properly structured and the employer complies with IRC Section 101(j). Section 101(j) applies to employer owned life insurance 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.*
4. *There may be state law requirements regarding the corporate redemption of stock.*
5. *Your tax and legal advisors may provide you with a full list of advantages and disadvantages of the different types of buy-sell arrangements.*

Agreement Provisions Limiting the Transfer of Ownership

- No Shareholder/Member shall sell, assign, transfer, pledge, dispose of or otherwise encumber any of his or her interest in the Corporation except as provided in the Agreement.

Comments and Recommendations:

1. *This type provision is very common and useful in a well drafted buy-sell agreement.*

Right of First Refusal Agreement Provisions

- For proposed sale to an outside party, there is a right of first refusal for the Corporation (first option) and remaining Shareholders (second option).
- The option price is the lesser of the third-party offer price or the price under the Agreement.

Comments and Recommendations:

1. *A right of first refusal purchase price is generally based on (a) the Agreement price; (b) the third party offer price; (c) or the lesser of the Agreement price or the third party offer price.*
2. *The Agreement uses the third method listed above.*

Mandatory Purchase and Sale Agreement Provisions

- *Death of a Shareholder is a mandatory buy-sell triggering event requiring the estate of the deceased Shareholder to sell with the Corporation obligated to purchase the shares of the deceased Shareholder/Member.*

Comments and Recommendations:

1. *Permanent disability of an active owner may be very disruptive to a business and is often a mandatory buy-sell triggering event for both the buyer and seller. Consideration should be given to including permanent disability as a mandatory buy-sell triggering event.*
2. *Life insurance and disability buy-out funding is discussed below.*

Agreement Provisions related to Purchase Options

- *If a Shareholder declares personal bankruptcy, the Corporation (first option) and other Shareholders (second option) will have the option to purchase such interest.*

Comments and Recommendations:

1. *The divorce of a Shareholder is often a buy-sell optional trigger if the spouse of the Shareholder is awarded Shares pursuant to the divorce. The parties may wish to consider adding such an event as a buy-sell purchase option.*
2. *Termination of employment (both voluntary and involuntary) is often a buy-sell optional trigger. Consider the advantages and disadvantages of adding termination of employment as a buy-sell purchase option.*
3. *Loss of a professional license is often a buy-sell optional trigger. Consider adding loss of professional license for a specified minimum period of time as a buy-sell purchase option.*

Agreement Provisions related to Purchase Price

- *The purchase price is a stated value in the Agreement to be updated each year.*

Comments and Recommendations:

1. *The purchase price does not appear to have been updated since the Agreement was executed.*
2. *In the near term, consider updating the valuation and complying with the procedural requirements of the Agreement.*
3. *Consider adding a back-up means of determining the purchase price to be used if the stated value has not been updated for a period of time specified in the Agreement. .*
4. *Principal offers a free informal business valuation service using several business valuation formulas. This requires at least three years of Company financial statements or Company income tax returns.*

Agreement Provisions related to Terms of Purchase

- The terms of the purchase require 30% of the purchase price as a down payment with the balance of the purchase price plus 5% interest compounded annually paid in equal installments over five years.
- Upon the death of a Shareholder, life insurance proceeds must be applied to the purchase price.

Comments and Recommendations:

1. *The parties may wish to compare the likely cash needs of the Company to cash flow upon 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.*
2. *Life insurance and disability buy-out coverage may be very helpful in matching cash needs with cash flow.*

Agreement Provisions and other Information related to Funding of the Purchase Price

- The Agreement permits life insurance on the Shareholders.
- There are no provisions related to disability buy-out insurance on the Shareholders.

Comments and Recommendations:

1. *The parties may wish to review life insurance and disability buy-out coverage. The amount of insurance will depend upon the value of the business.*
2. *If disability buy-out coverage is purchased, consider a disability definition tied to the definition in the disability buy-out policy.*
3. *Consider adding provisions to the Agreement which address disposition of life insurance policies in cases where a Shareholder leaves the Company during his or her life. For example, a Shareholder may be given the option to purchase his or her policy in the event of the sale of a Shareholder's interest during his or her lifetime, or upon termination of the Agreement for any reason. The purchase price of a policy should be its fair market value according to recent IRS guidance. This is the value that the IRS will focus on for transactions between a Company and one of its shareholders involving the transfer of a life insurance policy, .*

Agreement Provisions related to Spousal Consent

- The Agreement has no spousal consent provisions.

Comments and Recommendations:

1. *The parties may wish to consider adding spousal consent provisions with the spouses signing the Agreement*

Dispute Resolution Provisions

- The Agreement does not include mediation or arbitration provisions.

Comments and Recommendations

1. *Consider adding mediation and/or arbitration provisions to the Agreement to help resolve any business disputes under the Agreement.*

Final Comments and Recommendations

- Please discuss this report with your tax and legal advisors.

Submitted by: Valued Producer

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Reviewed by: Advanced Solutions



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