

# SAMPLE DOCUMENT

## UNILATERAL BUY OUT AGREEMENT

– Sample for the use of legal counsel only –

This is an agreement between [*Name of Owner*] (the “Owner”) and [*Name of Buyer*] (the “Buyer”). This Agreement is effective as of the date when both the Owner and the Buyer have signed it.

### BACKGROUND INFORMATION

- A. The Owner is a Sole Proprietor engaged in the business of [*insert business description*] under the name of [*insert business name*] of [*insert city and state*] (the “Company”).
- B. The Buyer is a valuable business associate of the Owner.
- C. The Owner and the Buyer have agreed upon an arrangement for the purchase of the Company by the Buyer in the event of the death of the Owner.

*Comment: The drafter may also add disability, retirement and/or other termination from employment as a triggering event for a mandatory purchase and sale.*

THEREFORE, the Parties agree as follows:

1. **Purchase of Business Upon Death of Owner.** Upon the death of the Owner, the Buyer shall purchase the assets of the Company, and the estate of the Owner shall sell such assets to the Buyer. The assets to be purchased and sold shall consist of all the assets of the Owner used exclusively or primarily in the business of the Company, including (without limitation of the generality of the foregoing) trade name, patents, trademarks, goodwill, and all other intangibles, but excluding cash bank balances.
2. **Restriction Against Prior Sale.** During the term of this agreement, and so long as the Buyer is not in default hereunder, the Owner shall not sell, transfer, encumber, or otherwise dispose of all or any part of the assets of the Company, except in the regular course of business. This provision shall

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not prohibit the Owner from withdrawing reasonable amounts from the profits of the Company, nor operate to restrict the Owner in his sole control over the management of the Company.

3. **Purchase Price.** The purchase price for the assets of the Company shall be \$\_\_\_\_\_ [value of the Company]. The Owner and the Buyer may from time to time change this price by amendment of this Agreement. The Owner and the Buyer may agree in writing, either as an amendment of this Agreement or by a separate written agreement, as to the allocation of the purchase price to each asset purchased.

***Comment:** Often the buyer and seller are interested in very different allocations of the purchase price among the assets being sold. Under I.R.C. § 1060, a buyer and a seller must allocate the purchase price in the manner prescribed by I.R.C. § 338(b)(5), which requires the parties to divide assets into specified classes and apply a residual method in allocating purchase price among those classes. If the buyer and seller agree in writing as to the purchase price allocation or as to the fair market value of any of the assets, they are generally bound by such agreement. The buyer and seller will want to be consistent in reporting the allocation, as they are each required to file Form 8594 with the I.R.S.*

***Comment:** Instead of a fixed price, some agreements provide for an appraisal or computation of value by some formula. In the case of an appraisal, the drafter should address how the appraiser(s) will be selected, the necessary qualifications of such appraiser(s), the standard to be used by the appraiser(s) to determine value, whether valuation discounts should be applied (e.g., lack of marketability), and who will pay appraisal fees. For example, the following provision could be substituted:*

*The purchase price for the assets of the Company shall be the book value of those assets as of the date of death of the Owner (and the purchase price shall be so allocated to such assets), computed by the certified public accountant servicing the business as of such date in accordance with sound accounting principles and consistent with accounting methods theretofore used in the business. Such computation when made and certified shall be binding and conclusive. All operations of the business subsequent to the date of death of the Owner shall be for the account of the Buyer.*

**NOTE: OPTION 1 PRESCRIBES A CASH SALE. OPTION 2 PRESCRIBES SELLER FINANCING.**

[OPTION 1]

4. **Terms.** The purchase price to be paid for any purchase and sale of assets pursuant to this Agreement shall, except as expressly provided otherwise, be paid by the Buyer to the estate of the Owner in cash or by certified check at closing.

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[OPTION 2]

4. **Terms.** The purchase price to be paid for any purchase and sale of assets pursuant to this Agreement shall, except as expressly provided otherwise, be paid by the Buyer to the estate of the Owner at closing as follows:
- (a) **Cash Portion.** The Buyer shall deliver to the estate of the Owner at closing an amount of cash or a certified check equal to the greater of \_\_\_\_% of the total purchase price, or the amount of life insurance proceeds received by the Buyer on account of the death of the Owner, but not more than the total amount of the purchase price.
- (b) **Promissory Note.** Any balance of the purchase price not paid in cash at closing shall be paid by the Buyer's delivery of a signed negotiable promissory note (the "Note") in the original principal amount of the balance. The Note shall require payment of the principal amount in \_\_\_\_\_ [insert number of quarterly installments] equal consecutive quarterly installments together with interest at a rate per annum equal to the minimum rate necessary to avoid additional interest being imputed to this transaction for federal income tax purposes. The Note shall allow the prepayment of all or any part of the principal amount at any time without penalty. As security for the Note, the Buyer shall execute a pledge of the assets being purchased and sold in favor of any holder of the Note.

***Comment:** The above clause requires the assets subject to the sale to be pledged as collateral. This might not give the estate of the Owner enough protection. The main reason why the Buyer might default is that the business is not profitable. If this is a concern, it might be wise to require the Buyer to pledge personal assets as collateral.*

***Comment:** The above clause provides for a rate of interest necessary to avoid imputation of interest under federal tax provisions relating to below market loans (generally found in I.R.C. § 7872). Of course, the parties are free to provide for a higher interest rate if they so wish.*

5. **Closing and Transfer of Assets.** The closing of the purchase and sale prescribed in this Agreement shall take place as soon as practicable after the date of the Owner's death, but in no event shall it take place later than the date which is six months after the date of the Owner's Death, unless agreed to otherwise by the Buyer and the estate of the Owner. Upon the payment of the purchase price to the estate of the Owner, the estate shall execute and deliver to the Buyer all documents reasonably required to evidence such purchase. All rights of the estate in the assets specified in paragraph 1 shall thereafter belong to the Buyer. The Buyer shall not be liable to the estate of the Owner for any estate, inheritance, or succession taxes of the estate, whether by reason of the insurance proceeds or otherwise.
6. **Purchase of Insurance.** The Buyer shall purchase insurance on the life of the Owner for an amount equal to the purchase price set forth in paragraph 3 and name himself as beneficiary of the policies. All policies are listed on Schedule A attached hereto. The policies and any proceeds received therefrom shall be held by the Buyer for the purposes of this Agreement. The Buyer shall have the

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right to purchase additional insurance on the life of the Owner whenever, in the opinion of the Buyer and the Owner, additional insurance may be reasonably required to carry out the Buyer's obligations under this Agreement. However, the face amount of the insurance policies at the time of application shall not exceed the value of the Company as determined under paragraph 3. Any additional policies shall be listed on Schedule A and shall otherwise be subject to the terms of this Agreement.

The Buyer shall pay all premiums due on the policies purchased by him on the life of the Owner and shall exhibit proof of payment to the Owner within fifteen (15) days after the due date of each premium. The Buyer shall own the policies issued on the life of the Owner, but shall not, during the term of this agreement, modify or impair any of the rights or values under such policies.

***Comment:** This section makes no provision for the payment of premiums in the event the Buyer fails to pay a premium. The parties may wish to include a provision authorizing the insured to pay such premium and requiring the Buyer to reimburse the Insured for such payment together with interest.*

7. **Death of Buyer.** If the Buyer dies during the lifetime of the Owner, the Owner shall have the right, exercisable within thirty (30) days after the appointment of the personal representative of the deceased Buyer, to purchase all or part of the policies of insurance issued on the Owner's life. The purchase price shall be the fair market value of such policy, as determined under Treas. Reg. § 1.83-3(e) (or any successor provision). Upon the payment of such purchase price in cash, the personal representative of the Buyer shall transfer the ownership of such policies to the Owner. To the extent that the Owner does not exercise this right, the personal representative of the Buyer shall have the right to make such disposition of the policies of insurance as he may in his absolute discretion determine.

***Comment:** Some parties might want to exclude the above paragraph that provides the Owner with the right to purchase a policy on his own life, as some legal authorities suggest that an insured's right to do so, even if never exercised, could amount to an incident of ownership. See, e.g., Rev. Ruls. 79-46, 1979-1 C.B. 303 and 75-70, 1975-1 C.B. 301. On the other hand, other legal authorities have found no incident of ownership in similar situations. See, e.g., Smith, 73 T.C. 307 (1979); Morrow, 19 T.C. 1068 (1953); and Infante, T.C. Memo 1970-206 (1970).*

***Comment:** The above paragraph refers to an income tax treasury regulation to determine the policy's fair market value. This regulation technically applies to transfers of policies from employers to employees, not sales of policies, but it is nonetheless used here because it is the most recent treasury regulation addressing the valuation of life insurance, along with identical provisions in the regulations under §§ 79 and 402. Rev. Proc. 2005-25, 2005-1 C.B. 962, provides a safe harbor valuation formula, which many parties will likely want to use. As an alternative, parties could look to the older gift tax valuation formulas found under Treas. Reg. § 25.2512-6. Under either the gift tax or income tax formulas, with traditionally-valued permanent policies with no surrender charges, the fair market value will generally be close to net cash value.*

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8. **Termination of Agreement.** This Agreement is the entire understanding between the Owner and the Buyer and shall terminate upon the first to occur of the following events:
- (a) The death of the Owner, but such death shall not relieve the estate of the Owner and the Buyer from fulfilling the terms of this agreement.
  - (b) The death of the Buyer during the lifetime of the Owner, in which event the provisions of paragraph 7 shall apply.
  - (c) The bankruptcy of either Owner or Buyer.
  - (d) The forced liquidity of the Company.
  - (e) If the Buyer is also an Employee, the termination of the employment of the Employee for any cause.

If this agreement terminates by operation of paragraphs (c), (d) or (e), then Owner shall have the right to purchase the policies on his life owned by the Employee for thirty (30) days after the event giving rise to the termination. The purchase price of the policies shall be determined as set forth in paragraph 7, with date of termination being substituted for date of death.

9. **Amendment.** This Agreement is the entire understanding between the Parties and may be altered or amended only by subsequent written instrument signed by both the Owner and the Buyer.
10. **Persons Bound.** This Agreement is binding upon the Buyer and the Owner, their heirs, legal representatives, transferees, successors and assigns, who shall execute all documents necessary to effectuate the purposes of this Agreement.
11. **Benefit.** This Agreement is for the benefit of the Parties, their heirs, executors, administrators, successors, assigns and transferees.
12. **Execution of Other Documents.** The Parties agree to execute and deliver all documents and instruments which are necessary to carry out the terms and conditions of this Agreement.
13. **[Name of State] Law.** This Agreement is being delivered and is intended to be performed in [Name of State] and shall be construed and enforced in accordance with the laws of [Name of State].
14. **Headings and Gender Neutral.** Any headings are inserted solely for the convenience of reference, and are not a part of this Agreement, nor shall they affect its meaning, construction or effect. Any pronoun reference to masculine or feminine shall be read as to accommodate the gender of the Parties.

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**15. Prior Agreement.** This Agreement revokes all previous agreements among the Parties to the extent they are inconsistent herewith.

IN WITNESS WHEREOF, the undersigned have hereunto set their hands and seals on the day and year written opposite the signature.

\_\_\_\_\_ (SEAL)                      Date: \_\_\_\_\_  
Owner

\_\_\_\_\_ (SEAL)                      Date: \_\_\_\_\_  
Buyer

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## **SCHEDULE A**

Insurance Owned By Buyer

On Life of Seller

Life Insurance Policy Number

Death Benefit