Estate Planning in Partnerships

Working in a Partnership can reap many rewards, with the combined efforts of all of the partners equalling more than the sum of its parts. However, the effects upon the Partnership as a whole of the death of one of the partners can be devastating if insufficient thought and implementation is given to Estate Planning issues.

A partnership agreement is a must-have basic starting point. The partnership agreement will set out the rights and responsibilities of each partner, and their entitlements to the income and capital of the partnership. A partnership agreement will also set out the various ways in which the partnership can be terminated and how the value of the business is to be determined in the event of the termination of the partnership.

As important as a partnership agreement, is a mechanism whereby an outgoing partner can be sure that they (or their estate) will receive the cash payment due to them, as calculated pursuant to the partnership agreement, in as short a time frame as possible.

This is achieved via a Buy Sell agreement. A Buy Sell agreement is a document in which each partner of the partnership grants to the other or others a “call” option, whereby all the remaining partners can call upon the outgoing partner to sell their share in the partnership to the remaining partner(s). In the same document, each partner grants to the other(s) a “put” option, by which the outgoing partner can call upon the remaining partners to buy their share. This way, all the parties can enforce the purchase or sale of the outgoing partners share to the remaining partners.

More often than not, a Buy Sell agreement is supported by a Buy Sell Funding agreement. This is an agreement in which each of the partners agrees to maintain a life insurance policy against their own lives and to ensure that the value of that policy is kept in line with the value of that particular partner’s share in the business. The agreement goes on to stipulate that in the event of the death of one of the partners, the financial impact of the obligation of the remaining partners to purchase their share (under the “put” or “call” options) is reduced by the value of that insurance policy. In other words, the remaining partners need only find the amount of money which is the difference between the value of the deceased partner’s share of the partnership value and the life policy proceeds.

This makes a traumatic and unsettling time in the business easier to bear as the monetary imposition should (so long as the insurance cover is adequate) be minimal.

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