

The Baratelli Field Note

Practitioner analysis for principals, family-office executives, and their advisors

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Practitioner reference for the buy-sell amendment work that most owners discover they need at the worst possible moment - the trigger event itself. The five clauses most likely to be defective today, and the fix for each.

The Buy-Sell Agreement Audit: Five Provisions That Don't Survive 2026

Most existing buy-sells were drafted between 2010 and 2018, against tax law that no longer applies and case law that has since refined the §2703 boundaries. The good news: each of the five clauses most likely to be defective today is fixable in a routine amendment. The bad news: most owners discover the defect at the moment a trigger event occurs - which is the worst time to discover anything.

A buy-sell audit takes a competent attorney three or four hours. Spread across five owners and five years of operating leverage, it is among the highest-ROI legal work in private-company practice.

1. Fixed-formula pricing that no longer tracks FMV.

A 5x EBITDA formula written in 2014 may have reflected industry norm at signing. In 2026 the same industry trades at 7x or 9x. The buy-sell still produces 5x. Under §2703, if the formula no longer satisfies the "comparable to unrelated-party arrangements" prong, the IRS disregards the agreement for transfer-tax purposes - and the estate is taxed on actual FMV regardless of what the buy-sell says. **Fix:** review the formula against current industry comparables annually; document the review in board minutes; update when drift exceeds 25%. If the formula must remain fixed for governance reasons, recite in the agreement that the parties have considered current market multiples and selected the formula as their negotiated price.

2. Sunset-contingent valuation provisions.

Trust and buy-sell documents drafted between 2017 and 2024 are full of provisions that begin "If the federal estate-tax exemption decreases by more than 50%..." These were drafted as defensive language against the 2026 sunset that didn't happen. They now activate against a contingency that cannot occur - mostly harmless but creating interpretation friction. **Fix:** delete the contingency or convert to a more general "material change in tax law" trigger. Either approach is straightforward in an amendment.

3. Disability definitions that won't survive litigation.

"Permanent disability" without further definition is a landmine. Inability to work 40 hours per week? Loss of professional license (critical for law and medical firms)? Cognitive incapacity versus physical limitation? When the trigger event arrives, the family is litigating the definition in the worst possible circumstances. **Fix:** import a specific Social Security disability standard or define operationally - e.g., "unable to fulfill the duties of the role for ninety consecutive days as certified by two licensed physicians selected by [process]." Most family-business attorneys have specimen language; the work is selecting the right standard for the specific business.

4. Divorce-trigger language that captures innocent third parties.

Triggering on "filing of a divorce petition" sounds protective until the petition is withdrawn three months later and the trigger has already fired. Better triggers: entry of a final divorce decree, or actual transfer of equity to a non-spouse. The distinction matters - a buy-sell that fires on petition filing produces forced redemptions in cases that don't end in divorce. **Fix:** tighten the trigger to actual transfer events. Coordinate with the marital-settlement architecture in pre-nup or post-nup agreements where they exist.

5. §2704 lapsing-rights exposure.

Voting rights that lapse on death create estate inclusion under §2704. The exposure is often inadvertent: a buy-sell drafted to "preserve voting control during the owner's lifetime" inadvertently creates a lapsing right that pulls the previously discounted value back into the estate at death - destroying the discount the structure was designed to capture. **Fix:** review the voting structure for any rights that lapse on death, disability, or other triggering event. Restructure if exposure exists. The cleanest pattern: voting rights tied to ownership rather than to the individual, so transfers (rather than lapses) drive any change in control.

Bottom line: a buy-sell drafted before 2018 should be reviewed against current law at least once before any triggering event. The cost of the review is small. The cost of discovering a defect at the moment it matters is the entire structure.

Quick hits

Form 706 election deadlines. Nine months from date of death; six-month extension available on Form 4768. The extension is for filing, not for payment - estimated tax must accompany the extension request.

Crummey notice discipline. For ILITs and other irrevocable trusts using annual-exclusion gifts: written notice to each beneficiary within thirty days of contribution, with a reasonable withdrawal period (typically 30 days). Sloppy notice is the most common ILIT defect at audit.

Reasonable comp doctrine for S-corps. IRS continues to scrutinize owners taking artificially low salaries to convert wages into distributions and reduce SE tax. Document the comp analysis annually with industry comparables.

Recent T.C. Memo on buy-sell valuation. Watch for cases reinforcing that fixed formulas without current-comparable documentation are vulnerable under §2703. Practitioners should flag this in client annual reviews.

From the catalog

Family Business Succession - Chapter 6 walks the buy-sell agreement structure end-to-end with §2703 compliance worksheet, six trigger-event funding mechanisms (Figure 6.1), and the five-decision checklist for buy-sell amendment work. Companion workbook tab "Buy-Sell Review" is a working amendment-preparation tool.

Estate Planning Decoded - Chapter 3 covers the transfer-tax architecture (§§2001-2801) that buy-sells operate inside; Chapter 4 covers irrevocable-trust mechanics that interact with buy-sell drafting through §§671-679 grantor rules.

Both at baratelliinstitute.com.

If this Field Note was useful: the Baratelli Institute library includes a free buy-sell self-audit checklist - the same five-clause review framework above, in a one-page format you can take to your attorney. Available at baratelliinstitute.com at no cost.

Until next time -

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