

# THE TAX ASPECTS OF BUY-SELL AGREEMENTS



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# REDEMPTIONS

# REDEEMED SHAREHOLDER

## Complete Termination

- The redeemed shareholder has gain or loss equal to any difference between his or her amount realized and stock basis. The gain or loss may be ordinary or capital depending on how and how long the stock was held.

## Incomplete Termination

- If the redemption occurred in a series of transactions or the shareholder has 'constructive ownership' of some shares after the direct redemption of all his or her shares (subject to limited waiver), it is treated as a dividend.



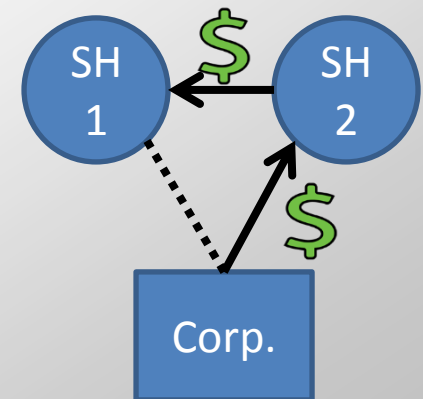
# THE CORP. & REMAINING SHAREHOLDERS

## Consequences to the Corporation

- Redemption payments are generally non-deductible and do not affect the corporation's basis in its assets.

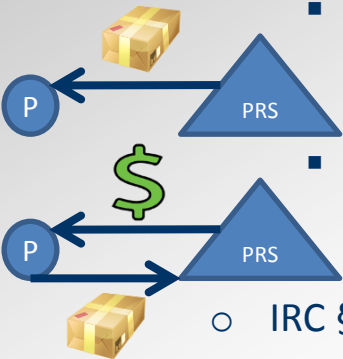
## Consequences to the Remaining Shareholders

- “Did the remaining shareholders have the primary obligation to purchase the shares?”
  - No: There are no tax consequences to the remaining shareholders.
  - Yes: The corporation is deemed to have paid the redemption price to the remaining shareholders, who are deemed to have paid the money to the redeemed shareholder.



# REDEEMED PARTNER

- IRC § 736(b): To the extent the payment is for the redeemed partner's interest in partnership property, it is a **distribution** by the partnership:
  - IRC § 751(b): To the extent a distribution is for that partner's interest in unrealized receivables or "substantially appreciated" inventory, the partner is deemed to
    - (i) receive the share of the unrealized receivables or inventory for which she is being paid cash, taking a basis in those assets equal to the lesser of the partnership's basis in them or her basis in the partnership, and then
    - (ii) sell those assets back to the partnership for the redemption payment, generating ordinary income equal to that deemed payment minus her basis in those assets.
  - IRC § 731: To the extent not treated under IRC § 751(b), above:
    - The redeemed partner has gain (ordinary or capital, depending on how and how long the partnership interest was held) to the extent the distribution exceeds the partner's basis in the partnership, minus the basis the redeemed partner took in any unrealized receivables or inventory under IRC § 751(b).
- IRC § 736(a): If capital is not a material income-producing factor and the redeemed partner was a GP, then, except as in (b), both distributive shares and guaranteed payments include unrealized receivables and unallocated partnership goodwill components.
  - A "distributive share" is determined by partnership income. IRC § 704(b).
  - A "guaranteed payment" is fixed. IRC § 707(c).



# THE PARTNERSHIP & REMAINING PARTNERS

## Consequences to the Partnership

- Amounts treated as guaranteed payments and distributive shares under IRC § 736(a): Generally deductible expenses to the partnership.
- The partnership adjusts its basis in unrealized receivables or inventory it is deemed to distribute to or repurchase from the redeemed partner in the amount of the deemed repurchase price.
- If an IRC § 754 election had been made, the partnership adjusts its asset basis by the amount of gain (or loss) recognized by the redeemed partner under IRC § 731.

## Consequences to the Remaining Partners

- Generally none. However, remaining partners may have deemed distributions if their shares of partnership debt are reduced or if the partnership redeemed the redeeming partner despite the remaining partners' primary obligation to do so.

# CROSS-PURCHASES

# CORPORATION CROSS-PURCHASES

## Consequences to the Selling Shareholder

- Generally gain or loss equal to the difference between the amount realized in the sale and his or her basis in the stock. The gain or loss may be ordinary or capital depending on how and how long the stock was held.

## Consequences to the Corporation

- None.

## Consequences to the Purchasing Shareholders

- The purchasing shareholders take a basis equal to the amount paid for the purchased shares.





# PARTNERSHIP CROSS-PURCHASES

## Consequences to the Selling Partner

- IRC § 751(a) Gain: Ordinary income equal to her share of ordinary income in a hypothetical FMV sale of the partnership's unrealized receivables and inventory.
- IRC § 741 Gain: The difference between the partner's total **gain** on the sale and her 751(a) gain is a capital gain or loss if she held such membership interest for more than one year.

## Consequences to the Partnership

- None.

## Consequences to the Purchasing Partners

- The purchasing partners increase their bases in the partnership by the amounts paid to the selling partner. If the partnership has an IRC § 754 election, the purchasing partners' bases in the partnership assets is adjusted by the amount paid to the selling partner.



# ADDITIONAL RESOURCES



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