**8811. What is the “redemption” type buy-sell agreement? How is this different from a cross-purchase buy-sell agreement?**

A “redemption” type agreement is structured so that it is the business entity (usually a corporation or LLC), rather than the individual owners, that agrees to purchase the business interests of a departing owner under a buy-sell agreement.[[1]](#footnote-1) A cross-purchase agreement is an agreement among owners whereby the remaining owners purchase directly from the departing owner the departing owner’s business interests..[[2]](#footnote-2)

In many respects, structuring a redemption-style buy-sell agreement may be much simpler than a cross purchase agreementbecause there is only one buyer, the corporation or business entity.Conversely, in a cross-purchase agreement, multiple buyers may be involved in the transaction, depending on the number of co-owners involved in the business. Funding a cross-purchase agreement can also prove more complicated than in a redemption context, especially if the agreement is funded by insurance policies owned by multiple shareholders, rather than the entity itself.

Choosing between a redemption or cross-purchase style agreement may trigger many non-tax issues. For example, state laws may restrict a corporation’s redemption of its own stock[[3]](#footnote-3) in cases where the redemption can risk the corporation’s insolvency or impair its capital.[[4]](#footnote-4) Conversely, there are no similar restrictions upon the sale of one stockholder’s shares to another stockholder under a cross-purchase agreement.

Sale of stock between the shareholders of a corporation under a cross-purchase agreement creates the same tax consequences as would the sale of the securities in any other context (see Q 8781 and Q 8782).

However, if the corporation participates in the purchase, as it does in a redemption agreement, the purchase may be treated as a dividend distribution.[[5]](#footnote-5)See Q 8812 for a discussion of IRC Section 302 redemptions and Q 8813 for a discussion of IRC Section 303 redemptions.

As a general rule, any payment by a corporation other than an S corporation to a shareholder will be treated as a dividend rather than a capital transaction even if the payment is made to redeem stock.[[6]](#footnote-6)

In the context of closely held corporations, characterization as a stock redemption is important for at least two additional reasons. First, if a redemption is treated as a sale or exchange, the basis of the shares retained by the seller, if any, is unaffected by the transaction. If redemption is treated as a dividend, the basis of the shares redeemed is added to the basis of the shares retained.[[7]](#footnote-7)

Second, if redemption is treated as a sale or exchange, the part of the distribution properly chargeable to earnings and profits is an amount not in excess of the ratable share of earnings and profits of the corporation attributable to the redeemed stock.[[8]](#footnote-8) If a redemption is treated as a dividend, earnings and profits of the corporation are reduced by the amount of money or other property distributed by the corporation.[[9]](#footnote-9)

1. . E.g., *Glacier State Electric Supply Co. v. Comm.*, 80 TC 1047 (1983), IRC Sec. 302. [↑](#footnote-ref-1)
2. . E.g., *Rodeo Family Enters., LLC v Matte*, 2011 N.Y. Misc. LEXIS 2004 (2011). [↑](#footnote-ref-2)
3. . See Revised Model Business Corp. Act. §6.40 (1984); Del. Code Ann. tit. 8, §160 (1974). [↑](#footnote-ref-3)
4. . See, e.g., Fla. Stat. Ch. 607.06401, N.C. Gen. Stat. §55-6-40, 11 Vt. Stat. Ann. 11A, §6.40. [↑](#footnote-ref-4)
5. . See IRC Sec. 304(a)(1). [↑](#footnote-ref-5)
6. . IRC Sec. 301(a), Rev. Rul. 55-515, 1955-2 CB 222. [↑](#footnote-ref-6)
7. . Treas. Reg. §1.302-2(c). [↑](#footnote-ref-7)
8. . IRC Sec. 312(n)(7). [↑](#footnote-ref-8)
9. . IRC Secs. 312(a), 316(a). [↑](#footnote-ref-9)