Tax Aspects of Buy-Sells

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This outline summarizes very generally certain of the federal income tax aspects of buying an owner (the "retiring shareholder" or "retiring partner," as the case may be) out of a business operated in the form of an entity classified for tax purposes as a corporation, on the one hand, or a partnership, on the other.[1]

I. REDEMPTION (PURCHASE BY ENTITY)[2]

a. Corporation.

1. Retiring shareholder. The tax consequences of the redemption to the retiring shareholder are generally determined under Internal Revenue Code ("Code") Section 302. A complete termination of the retiring shareholder's interest in the corporation in a single transaction generally results in the retiring shareholder being treated as having sold his or her shares, with the retiring shareholder having gain or loss (capital if the retiring shareholder held his or her shares as a capital asset, and long-term if the retiring shareholder held the shares for more than a year) equal to any difference between the amount he or she realizes in the redemption and his or her share basis.[3] A redemption payment to a retiring shareholder is treated as a distribution to the retiring shareholder with respect to his or her shares (and not in exchange for the shares), however, if the redemption does not satisfy any of the Section 302(b) tests (because, for example, the retiring shareholder continues to own too many shares, actually or by attribution, after the redemption).[4]

2. Corporation. Redemption payments (at least principal payments) are non-deductible (Code Section 162(k)). A redemption of a shareholder's shares has no effect on the corporation's basis in its assets.

3. Remaining shareholders. The remaining shareholders generally have no income unless they had the primary obligation to purchase the shares of the retiring shareholder, in which case the corporation's payments to the retiring shareholder are deemed to be distributed to the remaining shareholders, who are then deemed to use the amounts to buy out the retiring shareholder.[5] The remaining shareholders can also be deemed to receive taxable stock distributions under Code Section 305 if the redemptions are part of a periodic redemption plan having the effect of the receipt of money or other property by the retiring shareholders (in distributions to which Section 301 applies) and an increase in the interests of the remaining shareholders in the assets or earnings and profits of the corporation.

b. Partnership.[6]

1. Retiring partner. The tax consequences of the redemption to the retiring partner are determined under Code Sections 736, 751(b), 731 and 741 (and can be complicated). The amount paid to the retiring partner is deemed to include any reduction in his or her share of the partnership's debt.

1 Entities classified as partnerships for tax purposes include limited liability companies ("LLCs"), limited partnerships, limited liability partnerships and general partnerships (so long, in each case, as they have more than one owner and that have not elected to be classified as corporations).

2 It is assumed in this Section I. that any redemption is of entire interest of the retiring shareholder or retiring partner, as the case may be, for cash.

3 It should be noted that the attribution rules of Code Section 318 prevent the redemption of a retiring shareholder's shares from being a complete termination under Code Section 302(b)(3) if the retiring shareholder is deemed to own any shares held by remaining shareholders.

4 The tax consequences of a redemption payment that does not satisfy any of the Section 302(b) tests are generally determined under Code Section 301, if the corporation is a C corporation, or Code Section 1368, if the corporation is an S corporation. If the corporation is a C corporation, a redemption payment to a shareholder that is not treated as a payment in exchange for the shareholder's shares is a dividend to the extent of the corporation's current or accumulated earnings and profits (without any offset by the shareholder's basis in the redeemed shares).

5 Rev. Rul. 69-608, 1969-2 C.B. 42.

6 It is assumed in this Section I.b. and in Section II.b., after the redemption or purchase of the retiring partner's interest, the partnership has at least two remaining partners. See Section V. for a discussion of the applicability of the buy-sell rules to two-person partnerships.

A. *Section 736*. Section 736(b) provides that a payment by a partnership to a partner in liquidation of the partner's interest in the partnership is treated as a distribution by the partnership to the partner to the extent the payment is made in exchange for the partner's interest in partnership property. Any portion of the payment that is so treated as a distribution is then directed on to Sections 751(b), 731 and 741 (see below). Payments made by a partnership to a retiring partner that are not made in exchange for the retiring partner's interest in partnership property are treated, under Section 736(a), as "distributive shares" of partnership income if they are determined with regard to the income of the partnership or as "guaranteed payments" if they are determined without regard to the income of the partnership. Any such distributive share allocations and guaranteed payments are generally reportable by the retiring partner as ordinary income. If "capital is not a material income producing factor" for the partnership (i.e., the partnership is a service partnership) and the retiring partner is a "general partner," amounts treated as distributive shares or guaranteed payments under Section 736(a) include amounts paid to the retiring partner for his or her interest in (i) any "unrealized receivables" of the partnership (which exclude, for purposes of Section 736, depreciation recapture and certain other items that are included in the definition for purposes of applying Sections 751(a) and 751(b)) and (ii) any goodwill of the partnership in excess of the partnership's basis in the goodwill) except to the extent that the partnership agreement provides for a payment with respect to goodwill.[7]

B. *Section 751(b)*. To the extent that any amount paid to the retiring partner and treated as a distribution (rather than a distributive share or guaranteed payment) by Section 736 is in exchange for the retiring partner's interest in the partnership's unrealized receivables (including, among other things, recapture inherent in any depreciable/amortizable property) or "substantially appreciated" (value in excess of 120% of adjusted basis) "inventory" (which includes, in addition to traditional inventory, property income from the sale of which would be ordinary), the retiring partner is required by Section 751(b) to recognize his or her share of the ordinary income inherent in those partnership assets. Under the regulations currently in effect, the retiring partner is deemed to (i) receive the share of the unrealized receivables or substantially appreciated inventory for which he or she is being paid cash in a non-liquidating distribution from the partnership (taking a basis in the distributed unrealized receivables or substantially appreciated inventory equal to the lesser of the partnership's basis in those assets or his or her basis in his or her interest in the partnership) and then (ii) sell the distributed unrealized receivables or substantially appreciated inventory back to the partnership for the cash he or she is being paid for his or her interest in them. The deemed sale generates ordinary income for the retiring partner to the extent of any excess of the cash payment he or she is deemed to receive for the unrealized receivables or inventory over the basis he or she took in those assets.[8]

C. *Sections 731 and 741*. Any amount that is paid to the retiring partner, treated as a distribution (rather than a distributive share or guaranteed payment) by Section 736 and not deemed to have been paid to the retiring partner for unrealized receivables or substantially appreciated inventory in a deemed sale back to the partnership under Section 751(b) produces gain (or loss) for the retiring partner under Sections 731 and 741 (capital if the retiring partner held his or her interest in the partnership as a capital asset, and long-term if the retiring partner held the interest for more than a year) to the extent the amount exceeds (or is less than) the retiring partner's basis in his or her interest in the partnership as of the time immediately before the distribution.[9] For purposes of determining the amount of any such gain or loss, the retiring partner's basis excludes the basis he or she was deemed to take in any unrealized receivables or substantially appreciated inventory that were deemed to

7 Payments treated as distributive shares or guaranteed payments under Section 736(a) can also include amounts paid to the retiring partner in lieu of interest and amounts paid to the retiring partner in the nature of mutual insurance.

8 The current regulations require that each partner's interest in the gross value of each partnership asset be determined to measure whether any portion of the cash distribution to the retiring partner is in exchange for an interest of the retiring partner in the partnership's unrealized receivables or substantially appreciated inventory. Proposed regulations published in November of 2014 would, when finalized, value the partnership's assets at fair market value for purposes of determining the applicability of Section 751(b) and allow the partnership to determine the tax consequences of any distribution to which Section 751(b) applies using a reasonable approach adopted by the partnership consistent with the purposes of Section 751(b). Under the proposed regulations, Section 751(b) would apply to a cash distribution by a partnership in redemption of a retiring partner's interest if the distribution would reduce the retiring partner's "net Section 751 unrealized gain" with respect to the partnership (such a reduction would be referred to as the retiring partner's "Section 751(b) amount"). The retiring partner would have such a reduction to the extent of any net income that would have been allocated to him or her with respect to the partnership's unrealized receivables and substantially appreciated inventory if the partnership had sold its assets at fair market value (in the case of any asset subject to nonrecourse debt, not less than the amount of the debt) as of the time immediately before his or her redemptive distribution. If the distribution to the retiring partner would cause such a reduction, the consequences of the distribution would have to be determined under a reasonable approach adopted by the partnership consistent with the purposes of Section 751(b). The reasonable approaches could include a deemed allocation of unrealized ordinary income to the retiring partner (with corresponding increases in the retiring partner's basis in his or her interest in the partnership and in the partnership's basis in its unrealized receivables and substantially appreciated inventory) or a deemed distribution and sale-back like the one constructed by the current regulations.

9 Note that it is possible for the retiring partner to recognize both ordinary income and capital loss on the redemption of his or her interest. It is also possible for the retiring partner to recognize ordinary income in the Section 751(a) component of the transaction even if the retiring partner has an overall realized loss on the sale.

have been distributed to him or her and sold back to the partnership under Section 751(b).[10]

2. Partnership. Amounts treated as guaranteed payments to the retiring partner under Section 736(a) are generally deductible expenses for the partnership. Amounts treated as distributive shares of partnership income to the retiring partner under Section 736(a) generally have the effect to the remaining partners of deductible expenses because they (the remaining partners) would otherwise have to report the distributive share amounts. The partnership's basis in any unrealized receivables or inventory it is deemed to distribute to, and repurchase from, the retiring partner under Section 751(b) is adjusted to the amount of the deemed repurchase price.[11] In addition, if the partnership has an election under Code Section 754 in effect, the partnership increases (or reduces) its asset basis by the amount of any gain (or loss) recognized by the retiring partner under Section 731.[12]

3. Remaining partners. Because the profits and losses (and the component items of income, gain, loss and deduction) of a partnership are reported by its partners, the remaining partners get the benefit of their shares of the amounts paid to the retiring partner that are deductible as guaranteed payments or treated as distributive shares of the partnership's income. Any amounts by which the partnership can increase its bases in any of its assets will also inure, ultimately, to the benefit of the remaining partners. The remaining partners can have deemed distributions themselves, though, if their shares of any partnership debt are reduced or if they had the primary obligation to purchase the interest of the retiring partner.

II. CROSS-PURCHASE (PURCHASE BY ONE OR MORE OTHER OWNERS)[13]

a. Corporation.

1. Retiring shareholder. The tax consequences of the buy-out to the retiring shareholder are generally determined under Code Section 1001. The retiring shareholder generally has gain or loss (capital if the retiring shareholder held his or her shares as a capital asset, and long-term if the retiring shareholder held the shares for more than a year) equal to any difference between the amount he or she realizes in the sale and his or her share basis.

2. Corporation. The buy-out has no effect on the corporation or its basis in its assets.

3. Purchasing shareholders. The purchasing shareholders may not deduct the amounts they pay for the purchased shares, but they take bases in the shares they purchase equal to the amounts they pay for the shares (and therefore get overall basis increases in their shares of the corporation). Of course, if they've paid with amounts they received from the corporation as compensation or dividends, they've had to recognize income to get their basis increases. In addition, if they've paid with dividends, the amounts they've paid with were taxable both to the corporation and to them. Thus, if the corporation is the source of the amounts paid to the retiring shareholder, it may be more tax-efficient to have the corporation purchase the shares, at least if the corporation is a C corporation.[14] If the corporation is an S corporation, the differences to the remaining shareholders

10 If, after the finalization of the proposed Section 751(b) regulations discussed in footnote 8, the retiring partner is allocated unrealized ordinary income with respect to any unrealized receivables or substantially appreciated inventory of the partnership, his or her adjusted basis will be increased by the amount of income so allocated to him or her for purposes of determining the amount of any capital gain or loss he or she has on the portion of the distribution governed by Section 731.

11 If, after the finalization of the proposed Section 751(b) regulations discussed in footnote 8, the retiring partner is allocated unrealized ordinary income with respect to any unrealized receivables or substantially appreciated inventory of the partnership, the partnership's adjusted basis in the unrealized receivables or substantially appreciated inventory will be increased by the amount of income so allocated to the retiring partner.

12 If 50% or more of the interests in a partnership's capital and profits are sold within a period of twelve months, the partnership terminates for tax purposes under Code Section 708(b)(1)(B). For purposes of the termination rule, the liquidation of an interest in the partnership is not treated as a sale. See Regulations Section 1.708-1(b)(2).

13 It is assumed in this Section II. that any cross-purchase is of the entire interest of the retiring shareholder or retiring partner, as the case may be, for cash.

14 A cross-purchase arrangement may be more efficient, however, where the purchase is being funded with life insurance proceeds. For example, if a corporation has three equal shareholders and each owns a policy on the life of the other two, the two who survive the death of the first to die can receive their proceeds tax-free under Code Section 101 and then take full cost bases in the shares they purchase from the deceased shareholder's estate. If the corporation received the proceeds and redeemed the shares of the deceased shareholder, the survivors would get no increases in their stock bases (although they would if the corporation were an S corporation, but only of their pro rata shares of the insurance proceeds rather than of the entire amounts received by them and used to purchase shares of the deceased shareholder). Care must be taken, though to avoid the "transfer for value" rules of Section 101 with respect to the policies on the surviving shareholders' lives owned by the deceased shareholder.

between the entity redemption and a cross-purchase might be less significant or even non-existent.[15]

b. Partnership.[16]

1. Retiring partner. The tax consequences of the buy-out to the retiring partner are determined under Code Sections 751(a) and 741 (and can be complicated, but generally not as complicated as the consequences of a redemption).[17] The amount paid to the retiring partner is deemed to include his or her share of the partnership's debt.

A. Section 751(a). Under Section 751(a), the retiring partner recognizes his or her share of the ordinary income he or she would have to report if the partnership sold its unrealized receivables (which, again, includes recapture inherent in any depreciable/amortizable property of the partnership) and inventory (which, again, includes, in addition to traditional inventory, property income from the sale of which would be ordinary) at fair market value (in the case of any asset subject to nonrecourse debt, not less than the amount of the debt).[18]

B. Section 741. Any difference between the ordinary income reported by the retiring partner under Section 751(a) and the retiring partner's realized gain or loss on the sale (the difference between the amount realized by the seller in the sale and the seller's basis in his or her interest in the partnership) is gain or loss (capital if the retiring partner held his or her interest as a capital asset, and long-term if the retiring partner held the interest for more than a year).[19]

2. Partnership. If the partnership has an election under Code Section 754 in effect, the portions of the partnership's bases in its assets corresponding to the interest purchased from the retiring partner are adjusted, for the benefit (or to the detriment, as the case may be) of the purchasing partners, to the amount paid by the purchasing partners.[20]

3. Purchasing partners. The purchasing partners may not deduct amounts paid by them to the retiring partner. They do, however, include the amounts paid by them (including any shares of the partnership debt shifted to them from the retiring partner) in their bases in their interests in the partnership. In addition, if the partnership has an election under Code Section 754 in effect, they get special adjustments in their shares of the partnership's bases in its assets based on the amounts paid by them.[21]

III. DEFERRED PAYMENTS

a. Corporation.

1. Installment method. If a retiring shareholder sells his or her shares to the corporation or one or more of the other shareholders for a note (and the sale is treated as a sale for tax purposes), he or she can report gain using the installment

15 For example, suppose that an S corporation has three equal shareholders, A, B and C, each of whom has a $0 basis in his shares. A is being bought out at the end of a taxable year and will receive a total of $300,000 in three equal installments of $100,000 payable at the end of each of the following three years. Suppose also that, for each of the three years of the pay-out period, the corporation has $100,000 of taxable income, which is reported equally by B and C. If the corporation buys out A for its $300,000 note and makes a $100,000 payment to A at the end of each the three years of the pay-out period (without making any distributions to B and C), each of B and C reports $50,000 of the corporation's income for each of the three years and, at the end of the three-year period, has a basis in his shares (the shares he's held throughout) of $150,000. If B and C buy out A for their $150,000 notes and make $50,000 payments each to A at the end of at the end of each the three years of the pay-out period using amounts distributed to them by the S corporation, each of B and C reports $50,000 of the corporation's income for each of the three years and, at the end of the three-year period, has a basis in his shares (the shares he purchased from A) of $150,000.

16 Again, it is assumed in Section I.b. and in this Section II.b. that, after the redemption or purchase of the retiring partner's interest, the partnership has at least two remaining partners. See Section V. for a discussion of the applicability of the buy-sell rules to two-person partnerships.

17 A transaction that purports to be a redemption of a partner's interest by the partnership but that is funded with a contribution made by another partner (where the retiring partner's interest in the partnership effectively shifts to the funding partner) may be treated as a cross-purchase.

18 Note that inventory need not be "substantially appreciated" for Section 751(a) to apply to it.

19 It is possible for the retiring partner to recognize ordinary income in the Section 751(a) component of the transaction and a capital loss in the Section 741 component. It is also possible for the retiring partner to recognize ordinary income in the Section 751(a) component of the transaction even if the retiring partner has an overall realized loss on the sale.

20 If 50% or more of the interests in a partnership's capital and profits are sold within a period of twelve months, the partnership terminates for tax purposes under Code Section 708(b)(1)(B). The partnership is deemed to contribute its assets, subject to its liabilities, to a new partnership and then distribute the interests in the new partnership in its liquidation. The consequences of such a termination should be considered in structuring a cross-purchase that would terminate the partnership.

21 If the partnership terminates under Code Section 708(b)(1)(B) as a result of a cross-purchase, the purchasing partners get basis adjustments as a result of the terminated partnership's Section 754 election even if the "new" partnership does not make the election.

method. Under the installment method, the retiring shareholder reports his or her gain ratably as he or she receives principal payments.[22]

2. OID. The original issue discount ("OID") rules can require that interest accruing on a note be reported as it accrues if it is not payable as it accrues on at least an annual basis. In addition, amounts cast as principal on a note issued for purchased shares can be recharacterized as interest if the stated interest rate on the note is less than the "applicable federal rate."

3. Basis in shares. If a shareholder purchases shares from another shareholder using a note, the purchasing shareholder can generally include the principal amount of the note in his or her basis in the purchased shares.

4. Subsequent compromise. If the principal amount of a note issued by a corporation to a retiring shareholder is subsequently reduced, the corporation may be able to avoid having to report "cancellation of indebtedness" (or "COD") income if the amount of the note is not reduced to a point below the amount originally contributed by the retiring shareholder to the corporation for his or her shares.[23] If the principal amount of a note issued by a shareholder to a retiring shareholder is subsequently reduced by agreement between the purchasing and retiring shareholders, the purchasing shareholder should be able to avoid COD income by treating the reduction as a purchase price adjustment under Code Section 108(e)(5) to the extent of his or her basis in the purchased shares (in which case, though, he or she will be required to reduce his or her basis in the purchased shares by the amount of the reduction).[24] In either case, if the retiring shareholder has been reporting gain under the installment method, he or she takes the reduction into account prospectively in reporting any remaining gain from the sale.[25]

b. Partnership.

1. Redemption. For tax purposes, a retiring partner remains a partner until his or her interest has been completely liquidated, and the partnership's obligation to make deferred payments to him or her is not treated as debt. That can be good for the retiring partner because (i) he or she gets to recover his or her basis in its entirety against payments that are treated as distributions under Section 731 before reporting any gain (if the deferred payment obligation were treated as debt, only a ratable basis recovery would be permitted under the installment method), and (ii) the OID rules likely do not apply (although amounts in the nature of interest are still ordinary income under Section 736(a)). That can be bad for the remaining partners, however, because any increase in the basis of the partnership's assets corresponding to gain recognized by the retiring partner under Section 731 (if the partnership has an election under Section 754 in effect) is postponed until the retiring partner reports the gain.[26]

2. Cross-purchase. If a partner sells his or her interest to one or more other partners and the purchasers pay some or all of the purchase price with notes, the retiring partner does cease to be a partner, and the notes are treated as debt of the purchasing partners. Because the purchasing partners include the amounts of their notes in their bases in their partnership interests, they also get the benefit (or suffer the detriment, as the case may be) of adjustments in their shares of the partnership's bases in its assets based on the amounts paid by them if the partnership has a Section 754 election in effect. Amounts payable to the retiring partner with respect to the retiring partner's interest in unrealized receivables or inventory under Section 751(a),

22 Technically, the retiring shareholder multiplies the amount of each principal payment he or she receives by his or her "gross profit ratio" to determine the portion of the payment that is gain (with the balance of the payment being a recovery of his or her basis). The retiring shareholder's gross profit ratio is (i) the selling price of his or her shares (excluding any interest he or she is to receive) minus his or her basis in the shares (with any selling expenses he or she incurs included in his or her basis), divided by (ii) his or her selling price (minus any "qualifying indebtedness" assumed or taken subject to by the purchaser). The rules are more complicated if some or all of the amounts due the retiring shareholder are contingent. It should be noted that the installment method does not apply to a note issued to the retiring shareholder by the corporation in redemption of the retiring shareholder's shares if the redemption is not treated as a distribution in exchange for the retiring shareholders' shares under Code Section 302.

23 See *Fashion Park, Inc. v. Commissioner,* 21 T.C. 600 (1954). Note that the Internal Revenue Service has gone on record as disagreeing with the *Fashion Park* holding.

24 COD income might be more difficult to avoid if the debt being compromised (whether debt of the corporation or of a remaining shareholder) is to a third-party lender that financed the buy-out. See, for example, *Preslar v. Commissioner*, 167 F.3d 1323 (10th Cir. 1999).

25 See Rev. Rul. 72-570, 1972-2 C.B. 241.

26 A significant exception – and potential trap for the unwary – is that income recognized by the retiring partner under Section 751(b) is ineligible for reporting under the installment method (and the portion of any note issued to the retiring partner by the partnership allocable to unrealized receivables or substantially appreciated inventory deemed to be distributed to and repurchased from the retiring partner in the Section 751(b) portion of the redemption should be treated as debt for tax purposes, with all the attendant consequences, assuming it otherwise so qualifies). On the other hand, any basis increase for the partnership in its unrealized receivables or inventory due to the applicability of Section 751(b) should take effect immediately. Because the retiring partner reports any guaranteed payment to him or her for his or her taxable year with or within which ends the taxable year of the partnership for which the partnership is entitled to deduct the payment, attention must also be paid to the timing of the deductibility by the partnership of any deferred guaranteed payments.

however, are ineligible for reporting under the installment method.[27]

IV. RELEASE OF GUARANTEES

a. Corporation. In general, if a retiring shareholder of a corporation is relieved of a guarantee of debt of the corporation in connection with being bought out (assuming the guarantee really is just a guarantee and not a primary obligation of the shareholder), the retiring shareholder should not have to recognize COD income.[28]

b. Partnership. A partner is deemed to contribute to the partnership any increase in his or her share of the partnership's debt. Conversely, a partner is deemed to receive a distribution in the amount of any reduction in his or her share of the partnership's debt. If the release of a partner's guarantee results in or accompanies any reduction in his or her share of the partnership's debt, the reduction is an additional amount deemed to be received by the partner in the transaction.

V. TWO-PERSON PARTNERSHIP

Code Sections 736 and Section 741 apply, by their corresponding regulations, to a partner who is being bought out of a two-person partnership.[29] Thus, the flexibility afforded partners in structuring their buy-sell arrangements applies even in the two-partner context. The buy-out documents should clearly specify the parties' intentions regarding tax treatment and should effect the buy-out as consistently as possible with those intentions.[30] Notwithstanding the treatment of the retiring partner, however, where one partner of a two-person partnership buys out the other partner, the buying partner is treated as if (i) the partnership had liquidated, distributing to the partners their shares of the partnership's assets, and (ii) the buying partner had then bought from the retiring partner the retiring partner's interest in the distributed assets.[31]

VI. ALLOCATIONS FOR YEAR OF BUY-OUT

a. S Corporation. An S corporation shareholder who is bought out during a taxable year of the S corporation must report a share of the S corporation's profit or loss for the year. The amount of profit or loss allocated to the retiring shareholder for the year affects his or her share basis and therefore the tax consequences of his or her buy-out. The default rule under Code Section 1377 is the "pro rata" method. Under that method, the S corporation's income for the year is divided by the number of days in the year. Each day's share of the income is then allocated among the shares that were outstanding on that day on a pro rata basis. The result is that, if there's a disproportionate amount of income after the date of a transfer, the retiring shareholder can have to report some of that income. If the income is ordinary, it can have the effect of requiring the retiring shareholder to report more ordinary income and less capital gain (or even ordinary income and a capital loss) for the year of the transfer. Alternatively (assuming a complete termination of the retiring shareholder's interest), the corporation and all "affected shareholders" may elect to use an "interim closing" method. The interim closing method can provide a more certain result but is obviously more of an administrative burden.

b. Partnership. Under Code Section 706(c)(2)(A), the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership is terminated (whether by redemption or otherwise). If the partner and the partnership have different taxable years, the termination can result in the bunching of more than one year's share of partnership taxable income into the retiring partner's return for the year of the termination.[32] The retiring partner's share of the income of the partnership for the year of the termination is determined using an "interim closing" method unless the partnership agreement authorizes the use of a "pro rata" method.

27 See Rev. Rul. 89-108, 1989-2 C.B. 100.

28 See *Landreth v. Commissioner*, 50 T.C. 803 (1968).

29 A partner retiring from a two-person partnership is deemed, by the regulations under Section 736, to remain a partner of the partnership until all retirement payments have been made.

30 Most (if not all) states, including Massachusetts, permit single-member limited liability companies, so the buy-out of a member of a two-member limited liability company generally does not terminate the limited liability company's existence under state law (even though the buy-out may terminate the limited liability company's status as a partnership for tax purposes).

31 Rev. Rul. 99-6, 1999-1 C.B. 432.

32 For example, if the partnership's taxable year ends on June 30, 2017, the retiring partner's taxable year ends on December 31, 2017, and the retiring partner's interest is terminated on November 30, 2017, the retiring partner has to report income from the partnership for his or her taxable year ending December 31, 2017, both for the partnership year that ended on June 30, 2017 and for the partnership short year that ended, as to him or her, on November 30, 2017.

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