

Sunset Clause: The Missing Link to an Effective Buyer Value Option Program

Best Practices for designing a successful Buyer Value Option (BVO) provision



April 2009



Introduction

During the past decade, Buyer Value Option (BVO) programs have produced successful results with lower costs to the client; providing an excellent alternative to either guaranteed buy-out (GBO) homesale or direct reimbursement programs. The BVO Program is a form of homesale assistance typically offered by companies who provide a structured program designed to facilitate selling of the relocating employee's home. It allows payment of specific approved selling expenses, often including Realtor commissions and stated non-recurring closing costs, associated with the sale of the home. When administered properly, the program provides a favorable tax option for paying these costs, significantly reducing total relocation expenses for both the employer and the employee; a win-win solution.

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Program Overview

BVO programs written into relocation policies by Paragon are structured based on recommendations from the Worldwide ERC's Amended Value (AV) Sale process so that the payment of closing costs may be provided by the company without tax consequences to the employee. The program differs from traditional AV programs in that the relocating employee must attempt to market the home to find a ready, willing and able buyer in lieu of Paragon having the home appraised and providing a Guaranteed Buyout (GBO). The Company may benefit by avoiding the tax gross-up on the costs to sell the home and the program minimizes the financial risk associated with purchasing the home outright from the employee. However, there is a growing concern with the lack of a buy-out clause, commonly referred to as a "sunset clause", requiring the appraisal process to be enacted in order to establish a GBO offer with the transferring employee.

Program Structure Considerations

In 2005, the IRS issued Revenue Ruling 2005-74. While this ruling supports favorable tax treatment of AV programs, it does not specifically reference BVO programs. A careful reading of the Revenue Ruling suggests, and most industry professionals believe, that a properly structured BVO program which

adheres to the Eleven Key Elements, should receive the same beneficial tax treatment as the AV program identified in the Revenue Ruling.

The Eleven Key Elements

1. Any employee (“EMPLOYEE”) wishing to take advantage of the Amended Value Option who lists his/her home with a real estate broker must include a suitable exclusion clause in the listing agreement whereby the listing agreement is terminated upon the sale of the home to either the employer or the relocation company.
2. Under no circumstances should EMPLOYEE accept a down payment from any potential buyer.
3. Under no circumstances should EMPLOYEE sign an offer presented by any potential buyer.
4. EMPLOYEE enters into a binding contract (“Contract of Sale”) with his/her employer or the relocation service company (“PURCHASER”).
5. After the execution of the Contract of Sale with PURCHASER and after EMPLOYEE has vacated the home, all of the burdens and benefits of ownership pass to the PURCHASER.
6. The Contract of Sale between EMPLOYEE and PURCHASER at the higher price is unconditional and not contingent on any event, including the potential buyer obtaining a mortgage commitment.
7. Neither EMPLOYEE nor the employer in the case of a relocation company transaction exercises any discretion over the subsequent sale of the home by the PURCHASER.
8. PURCHASER enters into a separate listing agreement with a real estate broker to assist with the resale of the property.
9. PURCHASER enters into a separate agreement to sell the home to a buyer.
10. PURCHASER arranges for the transfer of title to the buyer.
11. The purchase price eventually paid by the buyer has no effect on the purchase price paid to EMPLOYEE.

Eventual Buy-out / Sunset Clause

In October, 2006, Peter Scott, Tax Counsel for Worldwide ERC, presented viewpoints during the Tax and Legal Update held at the Global Workforce Symposium regarding the BVO program and its relationship to the AV sale. He noted the only differences between the two programs, when properly structured, are that there are no up-front appraisals in a BVO, and no subsequent GBO based on them. While Scott felt a standard BVO should be treated the same as an AV within the ruling, he noted that it is not clear whether IRS will agree, and recommends that a BVO program provide for an eventual appraisal process leading to a GBO if the transferring employee is unable to procure a buyer. Doing so will reduce the company’s federal tax risk. This subject was also revisited in October, 2008 during the Tax and Legal Update held by Worldwide ERC in Washington, D.C., with the same recommendation.

Paragon's BVO Recommendation

While Buyer Value Option (BVO) programs are subject to a degree of interpretation, in taking a conservative approach, there are parameters which should be followed to ensure the program is tax-protected while facilitating employee mobility. Paragon recognizes the risks associated with a BVO program and understands the challenges in overcoming the potential expenses associated.

As markets soften, correct and/or decline, client corporations should consider a "sunset clause" for a Guaranteed Buyout Offer (GBO) at some time during the BVO process. Some key drivers for the "sunset clause" include:

- Companies that currently offer BVO as the only homesale option are becoming challenged with an increase in exceptions for temporary living, duplicate housing, and storage costs.
- An employee's move is not complete until they are relieved of the home disposition process and the family is all in one location.
- Although not a mandatory procedure according to Revenue Ruling 2005-76, Worldwide ERC's Tax Counsel recommends client organizations provide a GBO at the end of the BVO process in order to operate in the most favorable way to protect the tax exempt status of the third party relocation homesale program.

The "Sunset Clause" could take effect after the home has been on the market for no more than 6 months (180 days). Another consideration for this type of program is to base the guaranteed offer on a percentage of the appraised value. The same process for determining the value is followed except at the time of calculation, an employee is offered, for example, 95% of the appraisal value, resulting in the GBO amount. This approach may allow for an employee to have more incentive earlier in the process and facilitate a change in the strategies for selling a home prior to having to accept a GBO.

About the Author

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Katherine has over 28 years of experience in third-party relocation, in-house program management, corporate and consulting management for global and domestic programs. Her tenure includes development and implementation of policies and procedures to meet changing needs of client organizations as well as an expatriate assignment in Europe for a new business start-up. As a veteran Senior Certified Relocation Professional (SCRP) and a Global Mobility Specialist (GMS), Kathy has served as an active member of committees for the Worldwide ERC (Employee Relocation Council) and regional relocation networks. In addition, she has authored articles/editorials published in MOBILITY and National Relocation and Real Estate, has participated as an industry speaker and is a recipient of Worldwide ERC's Meritorious Service Award. Kathy has a BA in Journalism/Public Relations from the University of North Texas and formerly owned *Creative Resources, Inc.*, a relocation consulting organization. She is currently Vice President, Paragon Decision Resources.

About Paragon Decision Resources

Originally founded as a relocation consulting company in 1987 specializing in domestic and international relocation and global assignment program development consulting, our mission is to develop cost-effective mobility programs that offered more services to the transferring employee at less cost to the organization. Today we maintain an extensive consulting practice focused on global mobility issues in their entirety.

Paragon Decision Resources Inc. (PDR) is a wholly owned subsidiary of Paragon Global Resources, Inc. that is dedicated to strategic US domestic and global corporate relocation consulting services targeted at the executive level of organizations desiring to fully analyze their corporate relocation spending as well as supplier relationships.

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