**EMPLOYEE SPONSORED HOME BUYOUT PROGRAMS REVIEW**

For tax purposes, the government has been seeking ways to tax relocated employees on the amount that the employer gives to the relocation company on the employee’s behalf to facilitate the quick sale of the employee’s home. Also, the government has been attempting to re-characterize the employer’s deduction of the payment to the relocation company from an ordinary expense to a capital loss.

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Revenue Ruling 2005-74 (2005-51 IRB, 11-30-2005), represents an important win for the industry. It sets forth several fact patterns that dictate whether a transferred employee has additional compensation on the sale of the former residence to the employer.

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Since 1972, in Revenue Ruling 72-339, the IRS has maintained that if an employer-sponsored relocation home sale program is viewed as two separate sales (one from the employee to the relocation company or employer, followed by another from the relocation company or employer to a bona fide third-party buyer), then there are no payroll tax consequences for the employee following the second sale. In other words, the fee paid by the employer to the relocation company and the employer-paid costs of selling and closing the second sale would not be considered additional compensation to the employee. This also meant that employers didn’t have to match any related payroll taxes.

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Revenue Ruling 72-339, however, contained no guidelines as to what constituted two separate sales and what would be viewed as one sale. In 1985 the ERC published a list of the 11 key elements it believed would result in relocation home sales programs being viewed as two independent transactions. (See Supplement to the Guide for Managing the Mobile Work Force, Employee Relocation Council, 1999.) Those elements are as follows:

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* Any employee wishing to take advantage of the amended value option who lists 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.
* Under no circumstances should the employee accept a down payment from a potential buyer.
* Under no circumstances should the employee sign an offer presented by a potential buyer.
* The employee must enter into a binding contract of sale with the employer or relocation service company.

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After the execution of the contract of sale with the purchaser, and after the employee has vacated the home, all burdens and benefits of ownership should pass to the purchaser.

The contract of sale between the employee and the purchaser at the higher price should be unconditional and not contingent on any event, including the potential buyer’s obtaining a mortgage commitment.
Neither the employee, nor the employer, in the case of a relocation company transaction, may exercise any discretion over the subsequent sale of the home by the purchaser.

The purchaser should enter into a separate listing agreement with a real estate broker to assist with the resale of the property.
The purchaser should enter into a separate agreement to sell the home to a buyer.
The purchaser should arrange for the transfer of title to the buyer.
The purchase price eventually paid by the buyer must have no effect on the purchase price paid to the employee.

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**Case Law**

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The IRS did not respond to the ERC’s elements. In fact, the government remained silent on the issue for almost 12 years. Then, in 1997, in Amdahl Corp. and Consolidated Subsidiaries v. Comm’r [108 TC 507 (1997)], the IRS made its position clear.

In Amdahl, the employer paid the relocation expenses of its employees and provided financial assistance in connection with the sale of their residences. The employer hired a relocation company that paid employees the equity in their homes and paid the costs of maintaining the residences, including the mortgage and property tax expenses, until a third-party buyer was found to purchase the residence. The employer paid a fee to the relocation company and reimbursed it for all of its expenses. The IRS disallowed these deductions because it considered the employer to have acquired equitable ownership of the residences, and treated the payments as a capital loss to the employer. As opposed to ordinary expenses, which are deductible in full, such corporate capital losses could be used only to offset any corporate capital gains.

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Amdahl Corp. argued that the payments to the relocation company were employee benefits similar to reimbursed moving expenses, which are fully deductible. The employer also argued that it never acquired an ownership interest in the residences. The Tax Court stated that the threshold question was whether Amdahl acquired ownership of the residences. If Amdahl was found to be the owner of the residences, then the court would need to decide whether the residences were capital or ordinary income assets.

In reaching its decision, the court looked at the economic realities of the transaction. It looked at all of the relevant facts, circumstances, and written agreements to determine if Amdahl became the owner of the residences. Furthermore, it stated that a sale takes place when the benefits and burdens of ownership are transferred, rather than when the technical requirements for the passage of title under state law are satisfied. According to the court [see Grodt and McKay Realty v. Comm’r, 77 TC 1221 at 1237-1238 (1981)], the following factors are considered in determining whether a transaction constitutes a sale:​

* Whether legal title passes
* How the parties treat the transaction
* Whether any equity was acquired in the property
* Whether the contract creates a present obligation on the seller to execute and deliver a deed and a present obligation on the purchaser to make payments
* Whether the right of possession is vested in the purchaser
* Which party pays the property taxes
* Which party bears the risk of loss or damage to the property
* Which party receives the profits from the operation and sale of the property

The IRS conceded that because the employees signed blank deeds authorizing the relocation company, by power of attorney, to fill in the ultimate third-party buyer’s name, Amdahl never acquired legal title to the residences. The IRS argued, however, that Amdahl had acquired beneficial ownership of the residences, based upon the agency relationship between the relocation company and Amdahl.

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According to the Tax Court, however, if the relocation company were acting as an agent, it was acting as an agent of the relocated employee with the power to complete the blank deed. According to the court, Amdahl was not interested in the home’s long-term appreciation. The court agreed with Amdahl that the home-disposal program was a business expense to induce employees to move and to speed the relocation process. The entire transaction was structured to encourage employees to accept the employer’s offer to transfer. The contracts of sale merely gave the relocating employees their equity in their residences before the residences were sold. This enabled employees to purchase new residences with minimum delay. The contracts also relieved the relocating employees from the burden of having to pay duplicate mortgages, taxes, insurance, and other costs on both new and former homes simultaneously.

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Based upon the above reasoning, the Tax Court held that Amdahl did not acquire legal or beneficial ownership of the residences. The most significant factors in the decision were the fact that the relocating employees retained legal title; the intent of the parties; the executory nature of the contracts of sales; and the fact that the employees received any profits from the sale to the third parties. In essence, the relocating employees retained both the benefits and burdens of ownership of the residences. Thus, Amdahl was able to deduct all payments to the relocation company as ordinary and necessary business expenses and avoid having the payments re-characterized as capital losses.​

**Revenue Ruling 2005-74**

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In Amdahl, the employer-sponsored home relocation buyout program was treated as one sale (from the employee to the third-party purchaser), not as two separate and distinct sales. The primary factor relied on by the Amdahl court was the use of the “blank deed” by the relocation company. This blank deed prevented the relocation company (employer) from obtaining legal title to the employee’s former residence.

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Since Amdahl, employers and relocation companies have adapted a two-deed approach. The first deed is used to transfer the residence from the employee to the employer; the second deed is used when the property is resold to the ultimate third-party purchaser. IRS auditors, however, have continued to rely on Amdahl in questioning many company-sponsored relocation programs. Not willing to accept defeat in Amdahl, the IRS released Revenue Ruling 2005-74 (2005-51 IRB, 11-30-2005), which states that the IRS will continue to follow Amdahl in circumstances involving relocation service programs substantially similar to those in Amdahl.

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In Revenue Ruling 2005-74, the IRS applied the benefits/burden analysis of Amdahl to three different relocation scenarios, described below. Under the new standard, if the sale of the employee’s residence to a third party, with the assistance of an employee-provided relocation company, is viewed as two separate sales, then no compensation is taxed to the employee, even if a blank deed is used. If the transaction is treated as a single sale between the employee and the third party, however, then any employer-paid expenses to the relocation company on the employee’s behalf are treated as taxable compensation to the employee.

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***Situation 1***. An employer contracts with a relocation management company (RMC) to provide relocation assistance, including a home-purchase program, to transferred employees. Under the contract, the RMC will act as the employer’s agent in purchasing the employees’ homes at fair market value (based on its average appraised value) and reselling them to third-party buyers. The employer will pay the RMC a fee and reimburse the RMC for all costs incurred in purchasing and selling the homes. In addition, the employer is liable for any loss suffered on the resale. Transferred employees are required to sign a blank deed that is not recorded. The employee must then vacate the premises and deliver possession to the RMC. The contract of sale is not contingent or dependent on any subsequent event (such as finding a qualified third-party buyer). The RMC then becomes liable for all costs associated with the home (e.g., outstanding mortgages, taxes, insurance, or maintenance)

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Using the Amdahl eight-factor benefits/burden test of ownership, the IRS concluded that the sale of the home by the employee to the employer through its agent, the RMC, results in a complete sale. Accordingly, any amounts paid by the employer to the RMC will not result in additional compensation to the employee. This is in sharp contrast to Amdahl, where the Tax Court found that no sale took place between the employee and the employer because the employee retained legal title by using a blank deed. Could this mean that the IRS will argue, as it did in Amdahl, that the home, in the hands of the employer, is now a capital asset and that any future expenses or loss on the home’s resale will not be ordinary in nature?

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***Situation 2***. The facts are the same as in Situation 1, except that employees can also list their homes with a real estate broker under an “amended value option.” If a potential third-party buyer makes a bona fide higher offer, then the RMC will amend its contract of sale with the employee to match the higher offer. The employee will not sign any contract with nor accept any deposit from the third party. The RMC may then attempt to resell the home, through the real estate agent, to a third party, who may or may not be the potential buyer who made the offer. Upon resale, any excess profits will be remitted to the employer.

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The IRS viewed this situation as involving two separate sales. Because the sale of the employee’s home to the RMC was not contingent on its resale, and because any additional gain on the resale of the property accrued to the employer, the IRS concluded that no compensation was taxable to the employee in this scenario.

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***Situation 3***. The facts are the same as in Situation 2, except that the RMC is not required to offer a higher, amended value for an employee’s home based upon a third-party offer, unless and until the RMC enters into a sales contract with that third-party buyer. In addition, the employee retains the right to approve or reject any offer or counteroffer made in the course of negotiations between the RMC and the third-party buyer. Any additional proceeds from the higher amended value are given to the employee, not the employer or the RMC, but only if and when the sale to the third party closes.

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In Situation 3, the IRS concluded that, in substance, only one sale took place: by the employee to the third party, facilitated by the employer with the help of the RMC. Because of certain factors—the sale was contingent upon the RMC’s entering into a final contract with the third party; the employee retained the right to approve any offers or counteroffers; and any additional proceeds were remitted to the employee—the IRS found that any expenses paid by the employer directly or indirectly to the RMC, including maintenance costs, taxes, insurance, losses, and other costs associated with the home, were considered paid on behalf of the employee. As such, those amounts will be taxable to the employee as additional compensation, and subject to any related payroll taxes.

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Employers and relocation management companies that use the ERC’s 11 key elements and structure sales to conform to Situations 1 and 2 of Revenue Ruling 2005-74 should have no trouble treating the employee buyout as two separate sales, even if a blank deed is used. Most employers prefer the use of the blank-deed approach over the separate-deed approach because in most states the use of one deed will save significant recording costs.

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On the other hand, Situation 3 of the ruling resulted in only one sale taking place because the benefits and burdens of ownership were never transferred from the employee to the employer. In this scenario, the initial sales contract between the employer and the employee was contingent upon the employer’s finalizing a second contract with a third-party buyer; the employee was allowed to negotiate the final sale; and the proceeds were not given to the employee until the sale was closed with the third party.

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Revenue Ruling 2005-74 does not specifically mention buyer value options (BVO). A BVO is an amended value program, similar to Situation 2, but without the initial offer. BVO programs are popular with employers because they keep the inventory of employer-owned homes low and they reduce the costs of ownership to the employer. It would appear that a properly structured BVO program conforming to the 11 key elements would not result in compensation to the employee, especially if the BVO contains an eventual guaranteed appraised buyout clause.

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**Employee-Relocation Loans**

As an alternative to using a home buyout program offered by a relocation management company, an employer could offer a transferred employee an employee-relocation loan or a bridge loan. A bridge loan is an economical and safe alternative for small companies and for companies with few employee transfers. IRC section 7872 generally imputes compensation to an employee who receives a below-market-interest-rate loan from the employer; the compensation income is equal to the foregone interest (the difference between the current rate of interest and the amount charged by the employer). Treasury Regulations section 1.7872-5T(c) contains an exception, however, that allows an employer to make a bridge loan to an employee for purposes of acquiring a new principal residence in connection with a job change or a transfer, but only if the move qualifies under IRC section 217.

Under this exception, an employee who receives a below-market-interest-rate loan will not be charged with compensation income on the foregone interest if the loan is an employee-relocation loan that meets the following criteria:

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* The loan is secured by a mortgage on the employee’s new principal residence, bought in connection with his transfer to a new principal place of employment;
* The loan is a nontransferable demand loan whose benefits are conditional on the future performance of substantial services;
* The employee certifies that he will itemize his deductions each year that the loan is outstanding; and
* The loan agreement provides that the proceeds may be used only to purchase the employee’s new principal residence.

A loan that fails the first condition (i.e., it is not secured by the new residence) but satisfies the other three conditions will be treated as a bridge loan if it meets these additional conditions:

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* The loan must be paid within 15 days following the sale of the employee’s old principal residence;
* The amount of the bridge loan cannot exceed the employee’s equity in the old residence; and
* The old residence cannot be converted to business or investment use pending the sale.

**Advice**

To avoid unfavorable tax consequences, employer-sponsored home purchase buyout programs should avoid contingent sales that allow employees to negotiate the terms of the final sale.

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Although Revenue Ruling 2005-74 is silent on this point, the holding period between the two sales should not be too short. If the two sales are close in time, the IRS may view them as one.

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If a relocation program, especially a BVO, is found to be deficient in incorporating the ERC’s 11 key elements, steps should be taken to modify the program. In addition, the BVO program should include a delayed buyout offer that takes effect after a stated period of time.

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Finally, although Revenue Ruling 2005-74 does not address this issue, one can assume that in all three situations the sale of the old principal residence by the employee will qualify for IRC section 121 exclusion of gain on the sale of a principal residence ($250,000 if single and $500,000 if married filing jointly).

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