

# Transactions Update: Purchase Price or Compensation

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# Purchase Price v. Compensation

Companies are choosing to stay private significantly longer than the vesting period for stock options

Recent proposals by private companies to buy back stock from current and former employees at a price that may exceed its fair market value (Palantir)

Stock sales: Proceeds are capital gain to the seller, purchase price to the buyer

Compensation: Ordinary income to the service provider, deductible to the service recipient

What if there are elements of both in a transaction?

- Tax: Facts and circumstances
- Not always clear what may be the conservative approach, compensation is taxed a higher rate, but a company isn't allowed a deduction for purchase price

Note that for book purposes, the approach is likely to be different

# Transactions with Retention Elements

Overview of situation: A contract provides for a payment at closing and at future dates, with future payments to shareholder-employees conditioned on employment on payment date.

Factors to Consider Include:

- How do payments compare to payments to non-employee shareholders, if any?
- What are the service-related conditions?
- How do the parties characterize the payments?
- What is the course of negotiation?
- Is there otherwise adequate consideration for employment?
- Who benefits from forfeiture of a payment?
- How are the payments calculated?

# Purchases at Higher Values

Overview of situation: In connection with investment by a third-party, employee shareholders are given an opportunity to sell shares for a price higher than recent company valuations.

## Factors to Consider Include:

- Is the third-party purchasing the same class of equity being sold or a different class?
- Who is buying the shares?
- If the 3d party investor is purchasing, will they retain the shares, or can they put them back to the company for different equity?
- What is the purpose of the repurchase?
- How broad is the purchase offer?
- What is the timing relative to option grants or other equity-based transactions?
- If the company is the purchaser, is the transaction taxed as a redemption or dividend?
- Different treatment between current and former employees?

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