When an Owner Leaves

An owner walks away, or the others want them gone. The exit is easy to agree on and hard to finish.

Most owner exits start with a handshake: "I'm out, you keep it." Weeks later, the departing owner is still on the bank account, still listed with the state, still personally guaranteeing the lease, and still receiving a K-1 for a year they did not participate in. Nobody did anything wrong. Nobody finished the job.

The same thing happens whether the departing owner is a member of a limited liability company or a shareholder in a corporation. The documents have different names. The problem is identical.

An exit is complete only when the ownership, the money, the debts, and the records all say the same thing.

Start with the Governing Documents

In a limited liability company, look first at the operating agreement. In a corporation, look at the bylaws and any shareholder agreement; the buyout terms, if there are any, usually sit in the shareholder agreement. These documents usually answer less than people expect. Look for:

- **Withdrawal rights.** Whether a member may resign or withdraw at all, and on how much notice. Shareholders generally have no right to withdraw; they leave by selling their shares.
- **Transfer restrictions.** Whether an owner's interest or shares can go to the other owners, to the company, or to an outsider, and whose consent is required. In a corporation, look for a right of first refusal and a restrictive legend on the stock certificates.
- **Buyout triggers.** Death, disability, divorce, bankruptcy, termination of employment, or an owner who stops participating.
- **Valuation.** A fixed price, a formula, an annual agreed value, or an appraisal, and who chooses the appraiser.
- **Payment terms.** Lump sum or installments, interest, and security for unpaid amounts.
- **Expulsion.** Whether the other members can remove a member, and for what. Shareholders generally cannot be forced out unless a shareholder agreement says so, although a shareholder who is also a director or officer can be removed from those roles.

When the Documents Are Silent

If your documents do not address the exit, your state's default rules do. In many states, a member who withdraws from a limited liability company has no right to be paid for their interest until the company dissolves. In others, they may keep their economic rights indefinitely and

simply lose the right to vote. A shareholder with no buyout agreement simply keeps the shares, along with the right to dividends and to vote, until someone agrees to buy them.

Neither result is what most people picture. The practical answer is almost always a negotiated buyout, documented as one.

Who Buys: The Company or the Other Owners

A **redemption** means the company buys the departing owner's interest or shares. The remaining owners' percentages go up automatically. Company money funds it. In a corporation, redeemed shares are typically canceled or held as treasury stock, depending on state law.

A **cross-purchase** means the remaining owners buy the interest or shares personally. Each buyer's percentage goes up by what they buy, and they fund it themselves.

The difference matters most for tax. In a company taxed as a partnership, payments in a redemption can be treated very differently from the sale of an interest to another member, both for the departing member and for the ones who stay. In a corporation, a redemption can be treated as a sale or as a distribution, depending on how much the departing owner still holds afterward, including shares counted as theirs through family members. A cross-purchase gives the buyers a cost basis in the shares they buy; a redemption does not. Decide the structure with the tax result in view, not after.

Price and Payment

Agree on value, and say how you got there. A price with no basis invites a later claim that it was unfair, particularly from a departing owner who later learns of a sale or a large contract.

If the buyout is paid over time, use a promissory note with interest and a schedule. Decide whether the note is secured and what happens if payments stop. A departing owner being paid in installments is a creditor of the company, and should be treated like one.

The Debts That Follow

This is the part handshake exits miss.

- **Personal guarantees.** A departing owner who guaranteed a lease, a loan, or a credit line stays liable until the creditor releases them. The company's promise to hold them harmless does not bind the creditor. Get the release, or replace the guarantee.
- **Company debts.** Decide whether the buyout price accounts for them, and say in writing that the remaining owners and the company take the business with its liabilities.
- **Tax for the year of exit.** In a company taxed as a partnership or an S corporation, the departing owner will receive a share of the year's income or loss for the period they were an owner. Agree on how it is allocated and whether the company will distribute enough to cover their tax on it. An S corporation can elect, with the consent of the affected shareholders, to close its books on the date of exit instead of prorating the year.

- **Claims among the owners.** A mutual release, with any carve-outs stated plainly.

What Happens to the Tax Status

A limited liability company going from two members to one usually stops being taxed as a partnership. The final partnership return has to be filed, and the company becomes a disregarded entity unless it has elected to be taxed as a corporation.

An S corporation keeps its election when a shareholder leaves, as long as eligibility holds afterward: no more than 100 shareholders, only eligible shareholders, and one class of stock. A redemption or cross-purchase does not end the election by itself. Selling shares to an ineligible buyer, such as a nonresident alien or most entities, would. So would a buyout structured to give some owners different rights to distributions than others.

A C corporation keeps its tax status regardless of who owns it. The question there is whether the payment to the departing shareholder is taxed as a sale or as a dividend.

The Paperwork That Makes It Final

- **The transfer document,** signed by the departing owner. For a limited liability company, an assignment of membership interest or a redemption agreement. For a corporation, a stock purchase or stock redemption agreement, with the original certificate surrendered or a stock power signed.
- **Written approval,** as your documents require. The members or managers consent to a transfer of a membership interest. In a corporation, the board approves a redemption by written consent, and any required shareholder approval is documented the same way.
- **Updated ownership records.** The ownership ledger and operating agreement schedule for a limited liability company. New entries on the stock ledger for a corporation, showing the transfer or cancellation, and new certificates if the company issues them.
- **Resignation** from any manager, director, or officer role.
- **Bank signature cards updated,** and access to accounts, software, and records removed.
- **State filings corrected** wherever members, managers, directors, or officers appear on the public record.
- **An updated tax position,** as described above.

Related reading at bjoffrionconsult.com/blog: "Buying out a member: what actually has to happen" and "Your business partner stopped showing up. What can you do?"

If You Want This Answered for Your Company

Document Review — from $650. What your operating agreement, bylaws, or shareholder agreement actually says about withdrawal, transfer, valuation, and buyout, where it is silent, and what that means for this exit.

Signature Authority & Resolutions — from $450. The consents and resolutions approving the transfer or redemption, and who has authority to sign for the company.

Multi-Entity or Multi-Member Plan — from $1,600. How the company should be structured after the exit: ownership, capital, tax classification, and the provisions your governing documents need to address going forward.

The fee for a consultation is credited in full toward any written work you commission within 30 days.

Full service list and current pricing: www.bjoffrionconsult.com/services

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