

**FASB Emerging Issues Task Force  
Draft Abstract  
EITF Issue 07-6**

<b>Notice for Recipients of This Draft EITF Abstract</b>
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October 1, 2007

This draft abstract for EITF Issue No. 07-6, "Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66, *Accounting for Sales of Real Estate*, When the Agreement Includes a Buy-Sell Clause," addresses the following issue:

Whether a buy-sell clause represents a prohibited form of continuing involvement that would preclude partial sale and profit recognition pursuant to Statement 66.

The attached draft abstract reflects the Task Force's consensus-for-exposure reached at the September 11, 2007 EITF meeting. The Task Force invites individuals and organizations to send written comments on all matters within this draft abstract. Additionally, during its ratification meeting on September 26, 2007, the FASB requested that constituents provide comments on a number of matters raised during that Board meeting. Comments are requested from those who agree with the provisions in this draft abstract as well as from those who do not. Comments are most helpful if they identify the issue and the specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with the consensus-for-exposure presented in this draft abstract are asked to describe their suggested alternatives, supported by specific reasoning.

The Task Force and FASB specifically request that constituents provide comments on:

- a. Whether the proposed transition and effective date are appropriate?
- b. Whether any diversity exists between current practice and the consensus-for-exposure? For example, do you account for these transactions consistent with the consensus-for-exposure? If not, what methods have you used?
- c. Have buy-sell clauses like the ones described in the draft abstract been included in real estate transactions and, if so, to what extent? Also, if so, do the customary buy-sell clauses provide a basis for determining the offer price to be executed under the buy-sell clause (that is, fair value, specific price, other)? If yes, what basis is provided?
- d. How frequently have you or the other investors to your real estate transactions invoked the buy-sell clause?
- e. Are the factors of significant continuing involvement included in the draft abstract necessary or beneficial for a proper understanding of the consensus-for-exposure?
- f. Should any specific disclosure be required by the draft abstract and why?

### **New Format for FASB Documents**

This draft abstract has been written in a new format intended to improve its understandability. Notable changes from previous formats include the use of bold text at the beginning of each section to convey the accounting principle for that section and the inclusion of examples in the body of the standard to illustrate the proposed accounting guidance for certain paragraphs, when applicable.

Comments will be considered by the Task Force at the November 28 – 29, 2007 EITF meeting.

Responses from interested parties wishing to comment on the draft abstract must be received in writing by October 22, 2007. Interested parties should submit their comments by email to [director@fasb.org](mailto:director@fasb.org), File Reference No. EITF0706. Responses should not be sent by fax.

**EITF Issue No. 07-6, Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66 When the Agreement Includes a Buy-Sell Clause**

**Dates Discussed:** September 11, 2007; [November 28–29, 2007]

**Objective**

**1. The objective of this Issue is to establish considerations for determining whether a buy-sell clause is a prohibited form of continuing involvement that would preclude partial sales treatment under Statement 66.**

<p>All paragraphs in this Issue have equal authority. Paragraphs in bold set out the main principles.</p>
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**Background**

2. When investors enter into an arrangement to create a jointly owned entity and one investor sells real estate to that entity, a buy-sell clause often is included in the agreement between the investors. The buy-sell clause is a contractual term that gives both of the investors of the jointly-owned entity the ability to offer to buy the other investor's interest. In some cases the buy-sell clause may be executed at any time or in other cases only at some specified future date. When an offer is made pursuant to the buy-sell clause, the recipient of the offer can elect to sell its interest for the offered amount or buy the offeror's interest at the offered amount. Generally, once an offer is made, the offeror is contractually required to buy the other investor's interest or sell its interest at the offered amount depending on the other investor's election. A buy-sell clause can specify that the offer be at fair value, at a contractually specified amount, or at an amount determined by the offeror, which is the most common type.

3. Statement 66 includes guidance on the accounting for sales of real estate and criteria that must be met to recognize profit by the full accrual method. One of those criteria is that the seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property. For the purpose of this Issue, the seller is the investor who sold the real estate to the jointly owned entity. The buyer is the other investor in the jointly owned entity. If the seller has complied with all the provisions of Statement 66 to use the full accrual method but retains an equity interest in the real estate or has an equity interest in the buyer, Statement 66 requires the seller to account for the sale as a partial sale.

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<sup>1</sup> This draft abstract is being exposed for a public comment period that will end on October 22, 2007.

4. Paragraph 26 of Statement 66 indicates that if the seller has an obligation to repurchase the real estate or if the terms of the transaction allow the buyer to compel the seller or give an option to the seller to repurchase the real estate, the seller is considered to have a prohibited form of continuing involvement that would preclude profit recognition. Some have questioned whether a buy-sell clause would be considered a prohibited form of continuing involvement under paragraph 26 of Statement 66 and therefore preclude partial sale and profit recognition.

### **Scope**

**5. This Issue applies to a real estate sale transaction subject to the requirements of Statement 66 when the transaction includes a buy-sell clause.**

6. The scope of this Issue includes sales of real estate to an entity that is partially owned by the seller and the arrangement between the seller and the other investor of the jointly owned entity includes a buy-sell clause. Except for the potential effect of the buy-sell clause, the seller of the real estate as contemplated in this Issue has met the criteria in Statement 66 to recognize a partial sale. This Issue does not apply to transactions that are outside the scope of Statement 66.

### **Recognition**

**7. Determining whether the terms of the buy-sell clause indicate that the seller has transferred the usual risks and rewards of ownership and does not have substantial continuing involvement is a matter of judgment and requires consideration of all relevant facts and circumstances of the transaction at the time the real estate is sold.**

8. A buy-sell clause, in and of itself, does not constitute a prohibited form of continuing involvement that would preclude partial sales treatment under Statement 66. However, a buy-sell clause may constitute a prohibited form of continuing involvement if the buyer cannot act independently from the seller or if the seller is economically compelled to reacquire the other investor's interest in the jointly owned entity (thereby reacquiring the real estate). Determining whether the terms of the buy-sell clause constitutes a prohibited form of continuing involvement is a matter of judgment and all of the relevant facts and circumstances of the arrangement should be considered. Examples of factors that the seller should consider in its evaluation of whether the buy-sell clause constitutes a prohibited form of continuing involvement are included below. These examples are not intended to be presumptive or determinative.

*Factors that may indicate that the seller has substantial continuing involvement in the real estate:*

- a. The price specified in a buy-sell clause may indicate that the parties have already negotiated for the seller to acquire the buyer's interest. For example, a fixed price is specified in the buy-sell clause.
- b. The seller has a strategic necessity or an investment strategy that indicates that it cannot relinquish its ownership rights to the buyer and therefore compel the seller to reacquire full ownership of the real estate.
- c. The seller has arrangements with the jointly owned entity, such as management or third-party leasing arrangements, that may economically compel the seller to reacquire the real estate in order to retain the economic benefits (for example, leasing

commissions from lessees) or escape the negative economic consequences (for example, below-market contract with the entity) of such arrangements.

- d. Tax implications economically compel the seller to acquire the buyer's interest in the entity (thereby reacquiring the real estate).

*Factors that may indicate that the buyer can compel the seller to repurchase the property:*

- a. The buyer is financially unable to acquire the seller's interest. A requirement for an appraisal or for the offer price to be at fair value may provide protection to the buyer in such circumstances and provide evidence that the buyer is financially unable to acquire the seller's interest. However, a requirement for an appraisal may not be evidence of compulsion in other situations.
- b. The buy-sell clause stipulates a specified rate of return to the buyer (or seller), indicating that the buyer may not fully participate in the rewards of ownership from the real estate.
- c. The buyer has a strategic necessity or an investment strategy that requires that it sell its interest to the seller.
- d. The buyer is legally restricted from acquiring the seller's interest.
- e. If the real estate is integrated into the seller's business, the buyer may not have alternative means available, such as sale to an independent third party, to realize its economic interest.
- f. Tax implications economically compel the buyer to sell its interest in the entity to the seller.

### **Transition**

9. This Issue shall be effective for new arrangements entered into in fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted.

<b>The provisions of this Issue need not be applied to immaterial items.</b>
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### **References:**

FASB Statement No. 66, *Accounting for Sales of Real Estate*