

Undoing Deals and Do-Overs: How Far Can You Go with Backdating, Adding Partners, Rescission and More?

University of Texas Program on Partnerships and LLCs

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I. Introduction.....	2
A. Types of Temporal Modification	2
B. Reasons for Temporal Modifications.....	3
II. Legal Considerations.....	4
A. Efficacy of Temporal Modification.....	4
B. Protection of Third Parties.....	5
C. Criminal Sanctions.....	6
III. Bases for Non-Fraudulent Temporal Modifications	6
A. Memorialization.....	6
B. Clarification.....	6
C. Correction.....	7

D. Ratification.....	7
E. Void and Voidable Transactions.....	7
IV. Tax Considerations.....	7
A. Rescission.....	7
B. Backdating.....	14
V. Professional Responsibility Considerations.....	18
A. Legal Ethics Rules:.....	18
B. Circular 230.....	21
C. Tax Penalty Provisions.....	22
VI. Example: Backdated Stock Options.....	23
VII. Fundamental Rules.....	24

I. Introduction.

Rescission is the abrogation, canceling, or voiding of a transaction that has the effect of releasing the contracting parties from further obligations to each other and restoring the parties to the *status quo ante* as if the transaction had never occurred.¹ “Backdating” generally refers to assigning an event to a date prior to that of actual occurrence; or dating a document “as of” a time prior to execution.² Backdating and rescission are not mutually exclusive and are referred to collectively in this outline as “temporal modifications.”

Not all temporal modifications are illegal, unethical or even ineffective. Some ineffective but nonfraudulent temporal modifications may not be illegal or unethical. All fraudulent backdating is illegal, unethical and ineffective. This outline considers the circumstances in which an attempt to assign a date to an action that is different than the date on which the action actually took place will be illegal, unethical and ineffective.

A. Types of Temporal Modification

¹ Rev. Rul. 80-58, 1980-1 CB 181.

² For a comprehensive analysis on backdating (not focusing primarily on partnership/partner matters), see Jeffrey L. Kwall and Stuart Duhl, *Backdating*, 63 ABA Business Lawyer 1153-1186 (August 2008), available at SSRN: <http://ssrn.com/abstract=1112845>.

1. Nunc pro tunc initial action.

Some temporal modifications attempt to retroactively extinguish a transaction – viz a rescission – or create a transaction. Examples of rescissions include situations in which a sale or transfer is improvidently concluded, and the parties desire that the transaction had never taken place. Others attempt to establish that a relationship or arrangement existed before it actually did – for example, treating a person as having been admitted or as an owner or agent of an organization, or a contract or transfer is sought be effective prior to the time that the legal steps to create the organization, admit or remove of a member or enter into the contract or enter into the contract actually occurred.

2. Nunc pro tunc change.

An action having the effect of retroactively changing the terms of an existing transaction or contract. For example, a change in a partner's share of profits would constitute such a change.

B. Reasons for Temporal Modifications.

There are several circumstances in which temporal modifications may take place. Not all of them are inappropriate.

1. Defrauding a third party.

To the extent a third party's rights are determined by the date on which an action occurs, temporal modification may be intended to, or may serve to attempt to change the third party's rights. For purposes of this paper, the third party generally concerned is the Internal Revenue Service ("Service"). The use of temporal modification to obtain a tax or other benefit to which the actor would not otherwise be entitled for fraudulent purposes will generally be ineffective to accomplish the intended result – or in some case will achieve a result different than that intended by participants – and may subject the actor and those who provide assistance to civil or criminal penalties.

2. Non fraudulent memorialization of past actions.

There are several ways in which transactions may be reduced to a written document, even though they were taken before the document is reduced to writing. Among the most common memorialization is the preparation of minutes of a meeting at which an action was taken. Memorializations of transactions in written documents generally act as evidence of the transaction rather than the transaction itself. This is particularly true where there is not a requirement for a writing in order for the transaction to be effective. Partnership and operating agreements are another common circumstance in which a written memorialization may be prepared effective as of a date before the writing is created. Memorialization reflecting a modification of a partnership or operating agreement through course of conduct may also be appropriate. For example, when A and B are partners under a partnership agreement calling for each to receive 50% of the profits of the organization but allocations, distributions, and reporting on the partnership 1065 have reflected a 55/45 split, an amendment memorializing the actual deal would be appropriate.

3. Ratification of past action.

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