Generally when a successful business is acquired, whether by an asset acquisition or an equity acquisition, the assets will include both tangible and intangible property. When an entity conducting a business is liquidated, the tangible and intangible assets of the entity are distributed to the owners. Often, one very valuable intangible that does not appear on the balance sheet is goodwill. In many businesses, particularly service businesses, goodwill is often one of the largest, if not the largest, assets of the business. Indeed, in personal service businesses, the value of the goodwill may be a major multiple of all the other assets combined.

What Is the Relevance of Personal Goodwill to a Passthrough Entity?

As discussed below, there are two variations of goodwill—“enterprise goodwill” attributable to the entity and “personal goodwill” that is attributable to the individual. The failure to differentiate between enterprise goodwill and personal goodwill in the context of an asset sale, a liquidation of the business or the value of business in an estate can have negative tax effects not only in a C corporation context, but also even for a passthrough entity and its owners.

In the gift tax context, the value of an interest in a nontraded business that is being gifted may be significantly different if it is valued as though all the goodwill is enterprise goodwill. For example, if the older generation has substantial personal goodwill from founding and growing the business and still has the customer and/or supplier relationships that are creating the success, the recognition of personal goodwill in the matrix of the value may substantially reduce the value of the gift. In the estate tax context, the existence of personal goodwill of a family member of the deceased or of a third party that is critical to the success of the entity may have a dramatic effect on the value of the entity. If the deceased had substantial personal goodwill, the business’s future prospects may be less attractive than it was in the past and should be a factor in determining the value for estate tax purposes. In both cases, estate and gift values will include enterprise goodwill.
With respect to a sale or liquidation that would involve the disposition of enterprise goodwill, a few states without an individual income tax impose a corporate tax on S corporations, limited liability companies and limited partnerships. In essence, the limited liability company is equivalent to a C corporation for those states’ tax purposes. In those states, a sale (or perhaps a deemed sale via Code Sec. 336(e) or 338(h)(10)) of assets by the entity will incur an entity-level tax. Since personal goodwill is not an asset of the entity, any gain from its sale should not be included in the entity-level tax calculation.

Indeed, in personal service businesses, the value of the goodwill may be a major multiple of all the other assets combined.

It is possible that which state(s) will have the ability to impose a tax on the sale of the personal goodwill will be different (and their taxes more favorable or less favorable) from that of the state(s) able to impose taxes on the sale of enterprise goodwill. Particularly for S corporation shareholders, personal goodwill will often only be subject to tax in the state of the individual shareholder’s residence. The sale of S corporation enterprise goodwill will be taxable in accordance with the sourcing rules applicable to the entity, which may be a different state or a number of states. For shareholders residing in states without a personal income tax, there may be no income tax imposed on the sale of personal goodwill. Therefore, even when there is no federal tax difference between a sale of enterprise goodwill or personal goodwill, there may be significant state tax differences.

For S corporations, the distinction between personal goodwill and entity goodwill is particularly important if the S corporation (i) is to convert to a limited liability company or other entity taxable as a partnership which continues to operate with largely the same owners or (ii) sells assets and liquidates when the shareholders expect a greater share of sale proceeds. In those states, a sale (or perhaps a deemed sale via Code Sec. 336(e) or 338(h)(10)) of assets by the entity will incur an entity-level tax. Since personal goodwill is not an asset of the entity, any gain from its sale should not be included in the entity-level tax calculation.

Finally, in the context of an S corporation merging into another corporation, if shareholder personal goodwill exists and is transferred to the acquiring corporation in conjunction with the merger, the personal...
goodwill gain component potentially may be taxable. The reorganization provisions themselves do not shelter from gain consideration other than corporate stock or securities given in exchange for assets other than shares or certain other securities of a corporation that is a party to the reorganization.8 If the reorganization is such that the requirements of Code Sec. 351 are met and properly documented, gain recognition should be avoided. However, a substantial percentage of mergers do not involve contributions by the requisite percentage of shareholders.

**Definition of Goodwill**

The Regulations define goodwill as “the value of a trade or business attributable to the expectancy of continued customer patronage.”9 In 1893, in Metropolitan Bank v. St. Louis Dispatch Co., the U.S. Supreme Court defined goodwill as:

… the advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or influence, or punctuality, or from other accidental circumstances or necessity, or from ancient partialities or prejudices.10

Other cases have a broader reach and phrase the definition of “goodwill” along the lines of an intangible consisting of excess earning power of a business.11 This broader reach would encompass relationships with suppliers and others who are critical to the business.

**Enterprise Goodwill vs. Personal Goodwill**

Normally, when thinking of goodwill, one thinks of the goodwill of the business without necessarily thinking whether the goodwill is associated with the entity (enterprise goodwill) or with one or more of the individual owners (personal goodwill).12 Frequently, the goodwill of a business is composed of both enterprise goodwill and personal goodwill.13 The courts have recognized that goodwill is a vendible asset which can be sold in connection with the sale of a business.14 A given business may have both enterprise goodwill and personal goodwill.15

Enterprise goodwill is an asset of the business and may be attributed to a business by virtue of its existing arrangements with suppliers, customers or others as well as its anticipated future customer base due to factors attributable to the business.16

Personal goodwill is an asset that depends on the continued presence of a particular individual and may be attributed to the individual owner’s personal skill, training or reputation.17 Personal goodwill belongs to the individual, not the entity. Personal goodwill, however, can be transferred by the individual to the entity, in which case it becomes enterprise goodwill. As discussed above, theoretically such transfer for consideration could trigger gain to the transferring shareholder if transferring shareholders do not have sufficient ownership after the transaction to meet the requirements of Code Sec. 351(a)/368(c).

Divorce courts deal with the distinction between personal goodwill and enterprise goodwill more than courts dealing with tax cases. In those cases, the issue is whether the goodwill is personal (in many states, personal goodwill is an individual spouse’s separate property and nonmarital asset) or a separate asset of a practice, the value of which is a marital asset subject to division. The issue arises with some frequency in divorces involving a professional. In the author’s opinion, divorce court opinions may at best be helpful but not be the “best” authority to rely upon. Such cases, however, clearly demonstrate that personal goodwill and enterprise goodwill are separate property rights under state law. On occasion, even bankruptcy courts may analyze the distinction between personal goodwill and enterprise goodwill in the context of the bankruptcy.18 For federal and likely state tax purposes, the tax cases dealing with the existence of personal goodwill and the distinction between personal goodwill and enterprise goodwill probably should be the primary source of authority and analysis.

**Characterization of Personal Goodwill as an Ordinary Income Asset or as a Capital Asset**

From time to time, the author hears that no case states that personal goodwill is a capital asset and it may well be treated as ordinary income. This statement is partially true, but its conclusion appears incorrect. First, one can point out that personal goodwill, which is recognized as vendible property, falls within the definition of a “capital asset” as found in Code Sec. 1221(a). There, the Code defines “capital asset” as “property held by the taxpayer (whether or not connected with his trade or business),
but does not include ... [list of exclusions].” The list of exclusions does not identify “personal goodwill” or any other form of goodwill. As far as case law, the author is unaware of any case in which the court expressly rendered an opinion that personal goodwill is in fact a capital asset or that personal goodwill is not a capital asset. Perhaps that is because the IRS has not argued personal goodwill was not a capital asset, so the courts had no reason to so conclude since the issue was in effect conceded. Indeed, the case law support for the proposition that personal goodwill is a capital asset is found in cases the taxpayer lost. For example, in Howard, the issue was whether the dentist, Dr. Howard, was paid for a noncompete (ordinary income) or for his personal goodwill (which was reported as capital gain). The IRS did not argue that the personal goodwill was not a capital asset. The IRS argued that the payment was for a noncompete which constitutes ordinary income. As discussed later herein, the IRS prevailed in Howard on the characterization that the payments in controversy were for a noncompete and not for personal goodwill, and tax at ordinary income rates was applied.\textsuperscript{19, 20} If personal goodwill was not a capital asset, the court would not have attempted to differentiate the personal goodwill from a noncompete or compensation.

### Historical Perspective of Personal Goodwill

Although many seem to have the impression that personal goodwill is a fairly recent concept that began with Martin Ice Cream Co.,\textsuperscript{21} even as that case indicates, the concept of personal goodwill in the tax context is not new. The concept in tax cases goes back at least as far as 1925 in the context of the Revenue Act of 1918 and is found in the Board of Tax Appeals case of Providence Mill Supply Co.,\textsuperscript{22} where personal goodwill was not included in the invested capital of the corporation. More recently, the two leading (or oft cited) cases involving personal goodwill in the income tax context of a sale or liquidation of a business are Martin Ice Cream Co. and Norwalk.\textsuperscript{23} In addition, although less cited, another recent taxpayer-favorable personal goodwill case is H & M, Inc.\textsuperscript{24} These three cases will be discussed at length along with a shorter discussion of two additional recent cases. Also discussed will be several recent cases in which personal goodwill was not found and why. While the conceptual framework of personal goodwill is fairly clear, because it involves a facts-and-circumstances test, the application of the conceptual framework is often difficult. It should also be noted that the taxpayer has at least the initial burden of proof. Particularly in the context of a C corporation, transactions are often structured as involving a sale of personal goodwill that often will not stand judicial scrutiny if challenged. As discussed above, however, there are many situations in which the similar pressures exist in some passsthrough scenarios. It appears to the author that the IRS generally attempts to impose penalties when it recharacterizes the purported sale of personal goodwill as something else.

### Relatively Recent Cases Finding Personal Goodwill

Martin’s Ice Cream, Co. is the most frequently cited personal goodwill case. It did not involve a professional service corporation or even a service corporation, but rather a company that sold ice cream to supermarket chains, independent grocery and food service accounts. Martin Ice Cream Co. sets forth several important elements that anyone considering transactions that may include personal goodwill being sold separately or assets being distributed from an S corporation should take heed. This case is freely and frequently cited too broadly and in a manner that is inapplicable to the facts of a given situation. This leads to a significant amount of unfavorable taxpayer surprises.\textsuperscript{25}

Mr. Arnold Strassberg (“Arnold”), Mr. Martin Strassberg’s (“Martin”) father, had extensive experience in the ice cream market, designing packaging and working with supermarket chains and grocery stores. After a “falling out” with his ice cream supplier, Arnold’s company, Arnold’s Ice Cream failed and bankrupted in the late 1960s. As a result, Arnold had creditor issues following the demise of his company. In 1971, Martin and his father Arnold started a new ice cream company, Martin Ice Cream Co. (MIC) in which Martin, who did not have ice cream experience, owned all of the stock and started off working part time. By 1975, Martin was working full time. At no time did Arnold have either a written employment agreement or a noncompetition agreement with MIC. In 1974, Arnold was approached by the owner of Haagen-Dazs to distribute Haagen-Dazs ice cream into supermarkets, something that Haagen-Dazs had been unable to successfully accomplish, and through Arnold, MIC successfully exploited that market in several states. Arnold was offered the opportunity to partner with the owner of Haagen-Dazs, but declined. Neither Arnold nor MIC ever entered into a written distribution agreement with Haagen-Dazs. It was a handshake agreement between Arnold and Haagen-Dazs’ founder. Initially Arnold owned no MIC stock, but at some point in the late 1970s, Arnold acquired 51 percent of MIC. In 1985, Borden Co. retained Arnold...
to place its ice cream products into supermarkets and paid him a commission which did not involve MIC. By 1986, Pillsbury had acquired Haagen-Dazs and wanted to bring its distribution “in house” but could not reach an agreement with Arnold and MIC. Nevertheless, Haagen-Dazs, as a subsidiary of Pillsbury, continued to talk to Arnold. In early May 1988, the MIC board authorized the formation of a subsidiary of MIC called SIC, and later that month, negotiations resumed between Haagen-Dazs and Arnold. After such negotiations had resumed, SIC was actually formed.

Later in May 1988, the attorney for MIC wrote a letter to Haagen-Dazs memorializing terms discussed in meetings involving the purchase price of the distribution business of Haagen-Dazs’ products, contingent payments, annual payments to Arnold for three years and $50,000 a year to Martin in return for consulting services and a noncompete in the supermarket chain distribution area. Mr. Hewitt’s letter did not refer to any allocation of the total price between distribution rights, business records, etc. Pillsbury responded with a draft purchase agreement and related documents listing Arnold, Martin, MIC and SIC as Sellers and provided for the purchase of any and all of Sellers’ distribution rights, including but not limited to supermarket and food service distribution rights and their cancellation by the Buyer. In early June, Mr. Hewitt suggested a number of modifications to the proposed agreements. Chief among which was elimination of all reference to Martin and MIC as parties to the proposed sale. Pillsbury made a number of changes but wanted a side agreement that all rights to distribute Haagen-Dazs would be transferred to SIC and Martin would have no rights.

In June 1988, MIC executed documents transferring MIC’s interests in the supermarket business and associated pricing lists from MIC to SIC for the exchange of Arnold’s shares for MIC’s shares.

On June 20, SIC’s directors (Mr. Hewitt and Arnold) signed a directors’ resolution of SIC submitting to Arnold, as sole shareholder of SIC, an offer by Haagen-Dazs to purchase all of the rights of SIC to distribute Haagen-Dazs ice cream products, and Arnold signed a shareholder’s resolution to authorize SIC to enter into negotiations with Haagen-Dazs. There was apparently a degree of contention in the negotiation as Pillsbury’s attorney exhorted Arnold “to get out *** on the table” all relevant information required to complete certain financial issues in the draft agreement and whether the refusal of Pillsbury to deposit money in escrow on signing the purchase agreement would be a deal breaker requiring cancellation of a July 8 meeting to sign documents. Real negotiations were underway and it was not a done deal or simply changing names on papers.

The documents concerning the split-off provided only for the transfer of supermarket and food service distribution rights and records to SIC, but the Arnold-SIC-Haagen-Dazs agreement recited that SIC “owns all of the rights to distribute Haagen-Dazs products which were or may have been owned by Martin and MIC.” The $1.5 million purchase price was allocated $300,000 to “Records” and $1.2 million to “Sellers’ Rights” but there was no record of negotiating the allocation. Closing was contingent on an audit by a “Big-8” accounting firm of the documentation of the sale to supermarket chains, independent supermarkets and food service accounts for the 12-month period ending May 31, 1988, to generate the final purchase price and Haagen-Dazs could terminate the agreement if sales were less than $4 million. The resulting audit indicated that sales were less than represented but above four million dollars, and negotiations continued with Haagen-Dazs concerning accounts MIC would continue to service. The purchase price was adjusted downward for the reduced sales. Arnold signed the “Assignment of Rights” which transferred to Haagen-Dazs the assignment of the distribution rights to supermarkets and food service accounts in both his individual capacity and as president of SIC. Arnold also signed a three-year “Consulting and Non-Compete Agreement” with Haagen-Dazs at $150,000 per year. Martin signed a “Consulting and Non-Competition Agreement” with Haagen-Dazs for which he was to be paid $50,000 a year for five years, and Haagen-Dazs entered into three-year nonexclusive distribution agreements with MIC to specified small independent stores and food service accounts in a limited geographical area.

The tax case was framed by the IRS as a taxable 355 transaction, including the goodwill, in which the full purchase price was the recognized value triggering tax at MIC level and, in the alternative, a deemed sale by MIC under Court Holding Company rationale with gain recognized by MIC. Arnold’s individual return was not before the court.

With respect to the goodwill, the Tax Court held:

First, the personal relationships developed by Arnold with the supermarket chains and Arnold’s oral agreement with the founder of Haagen-Dazs were not

Unsuccessfully claiming personal goodwill can lead to substantial tax, costs and penalties.
assets of MIC that were transferred by MIC to SIC and thereafter sold by SIC to Haagen-Dazs. Arnold was the owner of those assets, not MIC.

Second, even though prior negotiations occurred, MIC was not the seller of assets to Haagen-Dazs. The final terms were negotiated by Arnold and SIC which were significantly different from the terms of the proposed transaction between MIC and Haagen-Dazs.26

Although Martin Ice Cream Co. is an unusual case, there are a number of important elements that will pertain to other transactions involving personal goodwill. It is crystal clear that Pillsbury was not interested in Martin’s market but rather wanted to acquire Arnold’s supermarket distribution rights obtained via an oral agreement and long history of utilization as well as a positive introduction to the supermarket chains and decision makers with whom Arnold had personal relationships.

1. Personal goodwill involves relationships with suppliers and customers and specialized knowledge or relationships that give rise to the expectancy of continued patronage. In this case, suppliers (Haagen-Dazs) and customers (supermarkets and certain food service accounts). Clearly, Arnold developed and had those relationships at the time of the transaction.

2. MIC never had a “right” to the customers or the Haagen-Dazs supplier as Arnold never had an employment agreement27 nor a noncompete. Those relationships were Arnold’s to use and to dispose of.

3. Personal goodwill can be sold and transferred to the purchaser. In this case following the transaction, Arnold was obligated to Pillsbury both not to compete and to provide services—services that would hopefully transfer the relationships to the purchaser. Arnold was separately reasonably compensated for his services.28

4. Even though discussions for a sale started with Arnold perhaps as an officer/employee of MIC, there was a real substantive change that occurred in a tight time frame (a period of approximately one month). This changed the deal with specific assets being transferred to SIC while others were retained, Arnold’s stock in MIC redeemed and each party was to be paid for such party’s assets or services. MIC actually received a limited distribution right from Haagen-Dazs. The author believes it is most important that it was clear from the outset that Pillsbury wanted the benefit of Arnold’s contacts and the extinguishment of the distribution rights that were subject to a verbal agreement between Haagen-Dazs’ founder and Arnold.29

5. This case does not characterize personal goodwill as a capital asset or as ordinary income as the issue was not before the court. The issue before the court was what did MIC sell, what was MIC deemed to be paid, and what was the value of the SIC stock exchanged for Arnold’s MIC stock? Arnold’s personal return was not involved in the case. The court found the assets that the IRS was claiming MIC sold or distributed were never owned by MIC but rather owned by Arnold individually.

The second case that is cited frequently for the proposition of personal goodwill is Norwalk. This involved the liquidation of a CPA firm, DeMartta & Norwalk, CPAs, Inc., which had two shareholders, Mr. DeMartta and Mr. Norwalk. The firm was started in 1985 and each of the shareholders had five-year employment agreements which contained a provision that, during or after the term of the employment, neither would disclose the list of corporate clients and could be enjoined from doing so. On the termination of the agreement, employees were not entitled to keep or preserve corporate records or charts as to any client unless the client specifically requested a different disposition of the records, and in no event should the employee be entitled to records of clients not serviced by him. Seven years later when the transaction giving rise to the tax case occurred, the employment agreements had previously terminated by their terms and neither Mr. DeMartta nor Mr. Norwalk was bound by a noncompete or an employment agreement. In 1992, the corporation had eight employees, four of whom were accountants and none of whom had signed noncompete agreements. The corporation had operated at a loss for most years. In mid-1992, the corporation distributed out its assets and liabilities in proportion to the stock ownership, ceased doing business but did not dissolve. Following the distribution, both Mr. DeMartta and Mr. Norwalk became partners of another accounting firm operating as a partnership and transferred the assets distributed to them to the new accounting firm which did not use the old name. The new accounting firm restricted its partners from competing. Some of the nonshareholder accountants went to work for the partnership in a capacity other than that of a partner, and within a few months, some of these individuals left to start their own firm and successfully solicited some of the former clients of DeMartta & Norwalk, CPAs, Inc.

Unlike Martin Ice Cream Co., in Norwalk the IRS audited and proposed adjustments (including penalties) to the corporation and each of the individual shareholders. The principal issue was as phrased by the court, “what is
the fair market value of corporation’s assets on the date of liquidation.”

The IRS argued that the assets distributed in liquidation included “customer based intangibles” in addition to the tangible assets which the corporation and the shareholders reported. The customer based intangibles included the corporation’s client base, client records and work papers and goodwill (including going concern value). The taxpayers argued that the corporation did not own the intangibles in question, but rather the accountants themselves owned the intangibles.

The Tax Court citing H.M. La Rue stated: “We have recognized that goodwill is a vendible asset which can be sold with a professional practice.” Therefore, if the court found that the professional corporation had goodwill, it could distribute it and gain would be triggered. The court determined that the goodwill of an accounting firm would generally be described as the intangibles that attract new clients and induce existing clients to continue using the firm. The intangibles may include (i) an established firm name, (ii) the general or specific location of the firm, (iii) client files and work papers, (iv) a reputation for general or specialized services, (v) ongoing working relationship between the firm’s personnel and client and/or (vi) accounting, auditing and tax systems used by the firm.

The court concluded that goodwill is the intangible comprising the excess earning power of a business. The court, citing Martin Ice Cream Co., noted it had previously held that there is no salable goodwill where the business is dependent upon its key employees, unless they enter into a covenant not to compete with the corporation or other agreement whereby their personal relationships with clients become property of the corporation. The court also cited a number of cases for the proposition that personal relationships of a shareholder-employee are not corporate assets when the employee has no employment contract with the corporation.

The court in essence did a facts-and-circumstances test with respect to each element it identified as common items of enterprise goodwill to determine if it existed in the current situation. The court found that most, if not all, of the clients of the corporation would follow the accountant who served the client if the accountant left the corporation. Supporting this finding, the court noted the number of clients that followed some nonowner accountants that started their own firm shortly after the distribution. Therefore, the relationships were with the accountants and not the corporation.

The court also found that the corporation did not have goodwill. Its name was not used; the location was not used; and there was no enforceable contract which restricted the practice of the accountants at the time of the distribution. The court did not address systems, perhaps because the two shareholders joining a larger firm would use the systems of the larger firm and therefore the systems of a defunct corporation were worthless. The court did not specifically address the work papers and files. The fact that clients could and did require the work papers and files relating to each such client be transferred to the accountants who departed and started their own firm may indicate that they had no value apart from the relationship of the individual accountant.

The court determined that the long-standing case law would not find the customer-based intangibles belonged to the corporation when the key employees were free to compete on the date of the distribution.

Norwalk presents the not uncommon situation of a professional service business in which the critical relationships that cause customers to return or come to the business lay with key employees who are not constrained from providing services elsewhere. Martin Ice Cream Co. presents the less common situation where the personal relationships of a nonservice business were clearly concentrated in a key employee-owner who was not constrained. A careful reading of both cases makes it clear that a noncompete agreement with the key personnel that survives an event or transaction would capture the goodwill for the entity and also indicates that an employment contract that tied up the employee could also capture the goodwill for the entity. Possibly, an employment contract that could be terminated on short notice or a noncompete that expired in the very near future would either not capture the goodwill or perhaps would only capture a small part of the goodwill.

H & M, Inc. involves another service company, an insurance agency owned by a corporation wholly owned by the insurance agent, a Mr. Schmeets. The corporation sold the agency to a bank, the individual insurance agent went to work for the bank and the individual insurance agent received payments from the bank for services. The audit was that of the corporation, not Mr. Schmeets. The IRS argued that part of the compensation that the bank paid Mr. Schmeets was really for intangible assets the bank purchased from the corporation. The court agreed with the IRS that the compensation paid Mr. Schmeets was excessive and represented consideration for something else. The court concluded that the intangible assets that were being purchased were for goodwill personal to Mr. Schmeets and for the noncompete agreement. The court stated: “… it is clear that some part of his [Mr. Schmeets] compensation wasn’t for his services, it’s not necessary for us to determine the exact allocation between what he was paid for his services to the agency,
his personal goodwill, and his promise not to compete, since Schmeets’s [sic] individual tax liability is not before us. In this case Mr. Schmeets was presumably reporting the payments received as compensation and not the sale of a capital asset."

The court’s tracking of at least some of the salient history of personal goodwill in *H & M, Inc.* is instructive. The court referenced (i) *Newark Morning Ledger Co.* in which the Supreme Court found that goodwill is an asset that can be sold with a professional practice; (ii) *La Rue* in which the court found that professional practices goodwill can attach to both the professional and the business; (iii) *C.S. Schilbach* in which the court described a facts-and-circumstances analysis of the particular case to determine who possessed and the value of goodwill; (iv) *Martin Ice Cream Co.* in which the court determined there is no saleable corporate goodwill where the business of the corporation depends on the personal relationships of a key individual; and (v) *Norwalk* for the proposition that, unless an individual transfers his or her goodwill to the corporation by entering into a covenant not to compete or other agreement so that his or her personal relationships become the property of the corporation, such property is the individual’s.

The *H & M, Inc.*'s court discussed *D.K. MacDonald* which was decided in 1944 and also involved an insurance brokerage business of a corporation which liquidated. In *MacDonald*, the IRS unsuccessfully attempted to tax the individual shareholder on the valuable intangible of goodwill which the IRS claimed passed from the corporation to the individual shareholder. The Tax Court held that no goodwill passed to Mr. MacDonald since any goodwill of the business was due to the personal ability, business acquaintanceship and other individualistic qualities of Mr. MacDonald which had never passed to the corporation. There was no contract or other agreement between Mr. MacDonald and the corporation for his future services. Following the discussion of *MacDonald* immediately prior to going into the details of *Martin Ice Cream Co.*, the Tax Court stated: “Time hasn’t seen much change in this part of the law. *Martin Ice Cream Co.* is a much more recent case, but we held there that a corporation could not be taxed on payments made to its controlling shareholder for his customer relationships.”

*Bross Trucking, Inc.* is another recent case in which the courts again recognize the distinction between enterprise goodwill and personal goodwill. In a usual factual scenario involving family members and a rogue trucking company owned by the patriarch, the court rejected the IRS’ argument that enterprise goodwill was distributed to Mr. Bross who then gifted it to his sons. The court analyzed the factual circumstances to determine that the trucking company did not have goodwill, and to the extent goodwill then existed, it was Mr. Bross’ goodwill. Mr. Bross started the company and the primary customers of the company were entities in which Mr. Bross or his relatives had ownership interests. Mr. Bross did not have a noncompete or employment contract with Bross Trucking, Inc., and had not transferred his goodwill to the company. This is another recent case wherein the court recognized the existence of personal goodwill in a business that was not a professional service business.

Finally, personal goodwill has also recently played an important part in an estate tax case. In *F.Z. Adell Est.*, the IRS issued an estate tax deficiency in excess of $39 million along with a valuation understatement penalty of another $15 million. The issue was the value of the estate’s stock of Satellite Television Network, Inc. (STN). There were many unusual circumstances including the fact that the son of the deceased had developed the idea of the business, controlled the primary customer of STN which was a nonprofit and had the key personal relationships with the ultimate sources of programming and revenue. On rather unique facts that could well be grounds for revoking the exempt status of the customer, the court found that a massive amount of the value was attributable to the personal goodwill of the son. The result was the original estate tax value was accepted by the court. Although the asset includible in the estate and the subject of the valuation dispute was a corporation, it could have just as easily been a limited liability company or other pass-through entity.

It should be noted there are a number of recent cases in which individuals attempted to claim personal goodwill associated with the sale of a corporate business and in which the courts found the individual did not have personal goodwill or was unable to prove the individual had such goodwill and its value. The results were findings that the IRS prevailed and the value was attributed to enterprise goodwill. These cases do not represent a repudiation of the doctrine of personal goodwill, but the application of the doctrine to specific factual situations that indicated the taxpayer was trying to put a round peg in a square hole. In each of these cases, the courts applied the basic analytics applied in *Martin Ice Cream Co.* of (i) was there goodwill; (ii) whose goodwill was it; (iii) if the goodwill was that of an individual (usually an owner), had it been transferred to the entity via a noncompete or similar agreement; and (iv) if personal goodwill exists and is being sold as part of the transaction, what is the value of any personal goodwill?

For example, in *R.L. Solomon* the corporation, Solomon Colors and its two individual owners claimed that the individuals owned and sold the customer list and
personal goodwill associated with Mather ore, a pigment, to Prince Manufacturing Co. ("Prince"). Favorable facts to the taxpayers included (i) neither of the individuals ever had an employment agreement or noncompete with Soloman Colors and (ii) the individuals managed the customer relationships with purchasers of Mather ore. A negative fact was the only other dealer of Mather ore in the United States was the buyer, Prince, and the initial transaction term sheet did not reference the purchase of anything from the individuals, the purchase of the customer list or goodwill. The court did not determine who owned the customer list as the court determined that the customer list had no value to Prince as it already knew who the customers were and, following the transaction, would be the only source of Mather ore (the specific pigment the customers required) in the United States. The court did not believe that personal goodwill was purchased by or transferred to the buyer. If any goodwill was purchased, it was the product and processes of Soloman Colors. The court determined that the consideration was for the non-compete of the individual owners and of Soloman Colors. The noncompete made it more likely that Prince would be the sole source of Mather ore following the transaction. The court examined the record of the transaction and found that Prince required the noncompete and, while the agreement required Soloman Colors to deliver the customer list, it provided that payment was to be to the individual shareholders. Inconsistent final documentation did not help the individuals’ argument for personal goodwill, and the internal documents obtained by the IRS (presumably through discovery) certainly did not help the argument that the individuals sold the customer list or personal goodwill.

A memorandum prepared by Soloman Colors’ accountant stated: “ … the only property available to purchase is their [sic] customer service list, because their [sic] process is worthless given the raw materials are not available … . It is arguable that truly the only thing Prince is buying is ‘market share,’ with a guarantee that Soloman will not compete with them [sic] as an entity, and, the shareholders will not compete with them [sic] personally.” The accountant referred to Martin Ice Cream Co. and concluded that the goodwill in the present situation was arguably more at the entity level.

It should be noted that 40 percent of Soloman Colors was owned by an employee stock ownership plan (ESOP), and there was concern about diverting funds from the company to the detriment of the ESOP. An email by the controller outlined a salary reduction by one of the individual shareholders that added cash flow to the company, offsetting over several years much of what the individual shareholders would receive. Handwritten notes of company counsel stated: “They are doing some creative tax planning by diverting some of the proceeds to the shareholders.”

The court rejected the IRS’ argument that the company distributed the customer list to the shareholders (which would trigger double taxation) but rather determined that the company sold the customer list to Prince per the agreement as part of the purchase price paid to the company. The court appears to agree with the accountant’s conclusions found in paperwork discovered by the IRS which the accountant prepared as the transaction was developing and determined the payments to the individual shareholders were for their individual noncompete agreements. Documentation flaws included:

1. The agreement references the customer list owned by Soloman Colors while the taxpayers desired to take the position that the individuals owned and sold the customer list.
2. The agreement to maintain the customer base after the sale was only signed by Soloman Colors and Prince, not by the individual shareholders.
3. Soloman Colors agreed to keep the identity of the customers confidential; the individual shareholders did not.
4. After the transaction, Prince needed the noncompete agreements of Soloman Colors and the individuals. As noted by the accountant, the purpose of Prince was to purchase market share and in this case that meant not having competition.
5. The individuals agreed not to compete. The individuals were included in the final agreements solely to guarantee that they would not compete with Prince and were not named as a seller of anything.
6. Prince required noncompete agreements but not employment or consulting agreements of the individuals, making it unlikely that Prince was purchasing the personal goodwill of the individuals.
7. After the transaction, Prince was left as the sole business in the industry. Prince did not need the goodwill of Soloman Colors or any of its key employees to succeed.
8. The agreement states that Soloman Colors and Prince shall work together after the sale to form a plan for the smooth transition … and that Soloman Colors shall refer its customers to Prince. The agreement did not discuss the individuals referring customers to Prince. A second recent and important personal goodwill case that the courts have recently decided is J.P. Kennedy. This is a case of a sole-shareholder personal service company (employee benefits consulting) that, on the surface,
should have been a factual situation that was a winner for personal goodwill. The individual shareholder started a consulting proprietorship and later incorporated and operated as a C corporation. The corporation only had two full-time employees, Kennedy and one other person. The court acknowledged that the clients would follow Mr. Kennedy and that Mr. Kennedy did not have an employment agreement or a covenant not to compete before the sale. The court found that the clients did business with the corporation primarily because Mr. Kennedy worked for the corporation. The documents called for 75 percent of the purchase price to be for personal goodwill. The IRS asserted that the 75 percent of the payments made to the taxpayer on which capital gain treatment was reported was ordinary income rather than capital gain.

The documentation generally followed the correct form, but there were a few flaws. There were three contracts: (1) Assignment of Know-How and Goodwill (between Mr. Kennedy and Buyer and contained a list of customers that Mr. Kennedy would attempt to transfer to the Buyer); (2) the Asset Purchase Agreement (which included a list of the same customers as the Assignment of Know-How and Goodwill and was between the corporation and the Buyer); and (3) the Consulting Agreement (between the corporation and the Buyer also had a noncompete for both Mr. Kennedy and the corporation). All three agreements apparently restrained Mr. Kennedy from competing. The court, citing *H. Butler,* noted that whether goodwill exists as a capital asset of a proprietorship and whether it was transferred are both questions of fact.

The court determined that Mr. Kennedy had the burden of proof that the payments were payments for his goodwill. The taxpayer can shift the burden of proof to the IRS if the taxpayer (i) provides credible evidence with respect to factual issues; (ii) met the substantiation requirements; (iii) maintained all required records; and (iv) complied with all of the IRS requests for information. Mr. Kennedy did not meet these conditions and therefore had the burden of proof.

The court found the overall purchase price was determined early on and the personal goodwill was injected toward the conclusion of the transaction without changing the economics of the transaction. The 75 percent was labeled as consideration for personal goodwill and the remainder for assets and a noncompete. However, there was no appraisal or other support for the 75 percent. In this case, as in *Soloman,* the IRS discovered various communications between and among the parties that demonstrated the personal goodwill discussion was prompted by outside legal and accounting advice as was the 75-percent figure. The overall consideration did not change as a result of the late addition of the personal goodwill.

The court found a lack of economic reality to the contractual allocation of the payments to goodwill and determined such allocations did not appear to genuinely reflect the relative value of the seller’s customer relationships compared to the value of the seller’s ongoing personal services. The court stated:

… the allocation of 75 percent of the total consideration paid by Mack & Parker [the buyer] to goodwill was a tax-motivated afterthought that occurred late in the negotiations…. But the decision to allocate 75 percent of the total payments to goodwill appears not to be grounded in any business reality. It did not reflect the value of goodwill in relation to the other valuable aspects of the transaction.

The court noted that Mr. Kennedy worked for the Buyer for 18 months for relatively meager amounts paid to his corporation and then to him under the Consulting Agreement. The IRS argued that the payments were for services or the noncompete. The taxpayer did not provide proof concerning the value of any personal goodwill. Having failed to provide proof, the court accepted the IRS’ argument and, since both payments for services and payments for the noncompete are ordinary income, the court did not have to allocate such amounts.

Competent support for the relative valuation as compared to the other valuable aspects of the transaction would likely have made this case a winner for personal goodwill. Probably, the percentage of the consideration allocated would have been substantially less than 75 percent, but it would have been far in excess of zero. This was a failure of proof, and taxpayers claiming personal goodwill outside a liquidation or deemed liquidation without a sale transaction should obtain a qualified appraisal to support their positions. Discussions of personal goodwill should start at the outset of a personal service transaction in order to maximize the likelihood of a court honoring the sale of the personal goodwill and be included in the first term sheet if possible.

This case, as well as *Soloman,* demonstrates that the initial paperwork, term sheets and other documentation demonstrating how the transaction unfolded is likely to be reviewed by the IRS. The courts want to determine what was really bargained for in the economic transaction.

This next case demonstrates that a noncompete is absolutely fatal to a sale of personal goodwill. In *Howard,* a dentist had incorporated his dental practice, entered
into an employment agreement and noncompetition agreement and practiced for over 20 years. Amazingly, the noncompetition agreement provided that as long as Dr. Howard held any stock in the corporation and for a three-year period thereafter, he would not compete. Then, he sold his practice to another dentist and that dentist’s professional corporation. The court gave no indication as to why these provisions were in contracts that the sole shareholder signed with himself. The purchase agreement stated that the goodwill “… represents a personal, noncorporate asset that is being conveyed individually by Dr. Howard …”48 The agreement allocated $549,900 for Dr. Howard’s personal goodwill, $47,100 for the professional corporation’s assets and Dr. Howard was paid $16,000 for entering into a noncompete agreement. Dr. Howard reported the $549,900 as a capital gain. The IRS asserted that the goodwill was with the corporation and the $549,900 was a dividend (then taxable at ordinary income rates).

The District Court and the Court of Appeals looked to the substance of the transaction and not merely the self-serving statements in the agreements. The court simply found that Dr. Howard was subject to a noncompete agreement and, under W. Norwalk, even when a corporation is dependent upon a key employee, the employee does not own the goodwill if the employee has entered into a covenant not to compete (or similar agreement) under which the employee’s personal relationships with clients may become the property of the corporation.

Dr. Howard argued that the purchase agreement impliedly terminated both the employment contract and the covenant not to compete, thereby transferring the goodwill of the practice back to Dr. Howard. While the Court of Appeals found this dubious, it stated that even if it were true, “… such a release would constitute a dividend payment, the value of which would be equivalent to the price paid for the goodwill of the dental practice.”49

In a warning to all professional service providers that choose to do business in corporate form, the Court of Appeals noted that Dr. Howard had chosen to conduct his business as a C corporation to take advantage of tax benefits that accrued to him over the years. “As one of the members of the panel [the judges hearing the oral arguments on the appeal] aptly observed at oral argument, ‘so having then made himself available to the advantages of using the corporation, and having entered into the agreements that he did with the corporation, then why should we [Court of Appeals] try then to allow him … out of what he got himself into.’”50 Careful documentation and economic reality need to be observed, and the seller should remember who will have the burden of proof.

Two important points to Howard.
1. The noncompete, by its terms, ran for three years after he ceased being an employee of the corporation. The argument that the sole owner would not enforce such a noncompete against himself or herself fell on the deaf ears of the judges.
2. A termination of a noncompete that is motivated by a sale transaction in which the owners may argue they were selling personal goodwill may well trigger gain at the time of the termination.

What Do the Cases Tell Us About Personal Goodwill in the Context of Transactions?

The concept of personal goodwill has been present for over 95 years.51 As the court in H & M, Inc. stated, although Martin Ice Cream Co. is a more recent case, the area has not changed over such time period. If the entity does not own the property, it cannot sell or distribute the property. However, if the key individual(s) are subject to a noncompete or similar arrangement, the goodwill intangible belongs to the business entity for tax purposes. The IRS has shown a particular hostility to personal goodwill and appears to win as many or more cases than it loses. Generally, the IRS attempts to impose penalties when disputing the sale or other transaction involving personal goodwill. Taxpayers should be comfortable the economic substance of the transaction, that the business deal actually involves personal goodwill, the individual(s) and not the entity owns such goodwill, the value is supported, affirmative actions are required to transfer the personal goodwill to the buyer and the transaction documentation is appropriate, internally consistent and executed by the proper parties.

For the buyer of the assets of a business that was operated in a passthrough entity, the classification of goodwill as enterprise goodwill or personal goodwill is largely irrelevant for federal income tax purposes. In each case, the buyer will have 15-year amortization and the seller will have capital gain. For a buyer of a business that is an S corporation in which a Code Sec. 336(e) or 338(h)(10) election is not made or is a C corporation the difference is dramatic—capitalization and no amortization or 15-year amortization. For the seller, a sale of stock or personal goodwill have the same tax result. In appropriate circumstances, personal goodwill may make or break a transaction from the seller’s standpoint. A double tax or even the additional tax from ordinary income
versus capital gain can make a transaction unattractive to the sellers. The failure to obtain the amortization for a substantial intangible may cause the prospective buyer to reduce the purchase price such that the transaction is no longer attractive to the sellers. This pressure often causes people to be very aggressive and overly optimistic.

Even though the executed documentation reflects a sale of personal goodwill, the courts are not bound by the form cast by the taxpayer as there are not competing interests. In order to determine the substance of the situation, as opposed to the mere form, the courts are particularly interested in the shape of the negotiations and whether the underlying facts demonstrate that personal goodwill exists for which the buyer in fact bargained and that the concept of personal goodwill was not parachuted later into the transaction without changing the parties’ pre-tax economics. The IRS and its counsel understand the court’s interest and do extensive discovery. Transaction-related emails and memos can be expected to be reviewed and depositions taken. Counsel and the other advisors to the transaction should be very careful as to what is in that record and how it will be viewed. The interjection of personal goodwill as an afterthought to the transaction is likely to be met with great judicial skepticism. The valuation, particularly in a sale transaction where consideration is apportioned among various assets and paid to various parties, will need to be effectively supported by a qualified appraisal. The burden of proof will start off with the taxpayer and, unless the taxpayer can come forward and meet certain other requirements, will remain with the taxpayer.

The existence of goodwill, who owns it and its value is a facts-and-circumstances analysis. The underlying facts count. The manner in which the transaction unfolded and what the parties really cared about are critical. The transaction documentation must be appropriate with the proper parties entering into the proper transactions. It is difficult to successfully say that an individual owner sold the intangible when the transaction documents provide that a different person or the entity sold the intangible. A noncompete in favor of the buyer is a prerequisite for the transfer of personal goodwill. Merely agreeing not to compete, however, may or may not be sufficient to demonstrate to a court that the buyer purchased personal goodwill as opposed to merely paid for a noncompete. The purchase of personal goodwill at times may require the owner not only to agree not to compete but also to actively assist the buyer in the transition of the personal goodwill from the individual to the entity or the buyer. Working for the business after the sale for a significant period seems to implicitly satisfy the efforts to transfer. In such case, the individual must be paid reasonable compensation for such work.

The taxpayer will have the burden of going forward with the proof both as to existence, ownership and value of personal goodwill. In many cases, it will be hard to prove that personal goodwill exists, was bargained for, was transferred to a buyer and had a meaningful value. The existence of a noncompete or similar agreement that vests the ownership of the personal goodwill with the entity will have already converted personal goodwill into enterprise goodwill. If personal goodwill has already been converted into enterprise goodwill, the individual has nothing to sell. The failure to provide the requisite proof as to the value of personal goodwill in the context of a sale or exchange will cause the taxpayer to lose, even if the taxpayer is able to establish personal goodwill existed and the taxpayer owned it. The author strongly recommends that a qualified appraisal be obtained to provide the proof necessary to shift the burden of proof to the IRS and support the taxpayer’s position in any sale or exchange involving personal goodwill. A conversion from a corporate form to a pass-through form should also have a qualified appraisal to establish the value of the corporate business if it is to continue or if it is simply a step in a sale transaction which will involve the sale of personal goodwill. If a subsequent sale occurs, clearly the enterprise goodwill and the personal goodwill should both have valuation support that ties into the economics of the sale transaction.

It is clear that personal goodwill exists in appropriate circumstances, particularly in closely held service businesses where critical personal relationships are the key to the success of the business or are the asset the buyer covets, and personal goodwill is a vendible asset in the context of a sale or other transfer of the business. A service business may have (and most likely has) a mix of enterprise goodwill and personal goodwill with the enterprise goodwill becoming larger with more employees and other service providers, particularly if all or a sizeable percentage of whom are bound by noncompetes. Under the appropriate facts, the personal relationships of the individual owners may give rise to personal goodwill even though the business is not a traditional service business. Does the individual actually have the skills, reputation and/or contacts that significantly enhance the business; has the individual previously transferred such to the entity; and does the buyer really want those property rights and actually negotiated to obtain them? If there are more than one owner, rarely does the personal goodwill neatly equate to the relative ownership of the owners.

Norwalk implicitly provides that a prior employment agreement and a noncompete that has run its term a few years prior to a transaction does not mean that the otherwise personal goodwill remains with the employer. The CPA shareholders of Norwalk had five-year employment and noncompete agreement which, by their original terms,
expired a few years prior to the liquidation in which all
goodwill was found to be personal goodwill. As Howard
indicates, an attempt to terminate a noncompete in the
context of an impending sale is unlikely to work. In the
author’s view, an employment contract that can be termi-
nated on fairly short notice without cause may not secure
the personal relationships and otherwise personal goodwill
for the employer. The case law has not yet illustrated this
point, but conceptually a noncompete or employment
agreement that terminates on a change of control or other
event should not lodge the personal goodwill in the entity
after the triggering event has occurred.

The tax law has a long history of step-transactions and
focusing on substance over form. For those personal
service businesses that have noncompete agreements,
terminating them when contemplating entering into a
sale transaction is likely to fail if audited and may sub-
ject the taxpayers to significant penalties. As the court in
Howard hinted, the distribution of goodwill by the
cancellation of the noncompete agreement or contracts
calling for multi-year employment may trigger the tax-
able distribution of the intangible from the entity to
the individuals. This can lead to immediate taxation.

A termination of a noncompete or similar agreement by
its original terms that was established well prior to the
envisioning of any specific transaction or the cancellation
when the business reason for having the restriction ceases
to exist generally should not trigger adverse tax effects.

The revision of noncompete agreements to provide for a
change to the noncompete agreements or the termination
of noncompete agreements would be very therapeutic. A
passage of a few to several years following such a
change to the noncompete agreements or the termination
of noncompete agreements would be very therapeutic. A
cancellation or modification in anticipation of a trans-
action is not likely to have a satisfactory result to the
taxpayers involved. Generally, the transactions involve
the sale of a business and gross receipts, gain and/or
income will be abnormally large for the business and/
or the taxpayer, and therefore, returns for such years are
more likely to be audited than the year by year reporting
of normal income and gain.

Conclusion

Personal goodwill exists in appropriate circumstances and
can be used to facilitate transactions and minimize taxes in
many situations—even those involving pass-through enti-
ties. If it has not previously been transferred to the entity
and is bargained for, properly documented and the value
supported in an economically real transaction, it should
withstand any challenge to its sale. The entity cannot sell
or distribute what it does not have. The IRS is inclined to
give particular scrutiny to the sale of personal goodwill. Tax
advisors should have situational awareness and examine
the facts before recommending structuring a transaction
to involve the sale of personal goodwill. Unsuccessfully
claiming personal goodwill can lead to substantial tax,
costs and penalties.

ENDNOTES

   59,981(M), TC Memo 2014-155, 2014 TCM (RIA)
   ¶2014-155.
2. Examples of states without an individual income
tax that imposed a corporate income tax (or
other tax measured by receipts) on limited
liability companies taxable as partnerships for
federal income tax purposes are New Hamp-
shire, Tennessee and Texas.
3. Code Sec. 1361(h)(1)(O). Note the special rule in
   the regulations for deemed distributions under
5. Presumably, the shareholders will have determined
   there will be disproportionate distributions prior to
   an actual sale of assets that may taint the S status with
   the result the asset sale proceeds would be
   subject to corporate and shareholder’s taxation.
   Interestingly, a Code Sec. 336(e) or 338(h)(10)
   election combined with disproportionate pricing
   of the sale of the shares will provide a different
   result under Reg. §11361-11(1)(2)(v) if the different
   prices are negotiated in arm’s length with the
   purchaser. There is no actual disproportionate
distribution. The Code Sec. 336(e) or 338(h)(10)
   transaction may involve several separate purchases
   at different prices from different shareholders over
   the course of 12 months. In many cases, it will be
difficult to establish that the pricing among differ-
ent shareholders was determined in arm’s-length
   negotiations with the purchaser when there is a
   single transaction. Note: Reg. §1336-1(a) provides
   that except to the extent inconsistent with Code
   Sec. 336(e) or the regulations, the principles of
   Code Sec. 338 and it regulations apply.
6. Code Secs. 351 and 368(c).
7. Under Code Sec. 721(a), if the entity is a part-
nership for federal tax purposes, no gain will be
recognized on the contribution of property in
exchange for an interest in the partnership.
   149 US 436, 446 (1893) (quoting J. Story, Part-
   nerships Section 99 (1841)).
11. See, for example, W. Norwalk, 76 TCM (CCH)
   208, Dec. 52,817(M), TC Memo. 1998-279, 1998
   TCM (RIA) ¶98,279.
12. “Accrued goodwill can be attributed to an indi-
   vidual employee or to a company, depending on
   the employment relationship between the two.”
   LEXIS 77251, 7 (E.D. Wa. July 30, 2010) (citing
   Martin Ice Cream Co., 110 TC 189, Dec. 52,624
   (1998)).
13. “...a professional practice’s goodwill can attach
to both the professional and the business…” H
   & M, Inc., 104 TCM (CCH) 452, Dec. 59,225(M),
   TC Memo 2012-290, 2012 TCM (RIA) ¶2012-
   290, at 19 (citing C.S. Schlibach, 62 TCM (CCH)
   TCM ¶91,556).
14. Norwalk, 76 TCM (CCH) 208, Dec. 52,817(M),
   TC Memo. 1998-279 (citing Martin Ice Cream
   Co., 110 TC at 207).
15. Schlibach, 62 TCM (CCH) 1201, Dec. 47,733(M),
In each of the following cases that are discussed later in this column, the taxpayer unsuccessfully used Martin Ice Cream Co. to attempt to support their position. R.L. Solomon, 95 TCM (CCH) 1389, Dec. 57,407(M), TC Memo 2008-102 (2008), J.P. Kennedy, 100 TCM (CCH) 268, Dec. 58,339(M), TC Memo 2010-206 (2010), and Howard, CA-9, 108 AFTR 2d 2011 (2011).

Although the court expressed this rationale, if the personal goodwill never belonged to MIC negotiating the sale of a shareholder’s assets does not trigger gain at the corporate level. However, this is a reminder that betting on personal goodwill toward the end of a transaction that retains essentially the same economics is unlikely to work.

Although the court referenced the fact that Arnold never had an employment agreement or noncompete, such agreements that expired by their terms well prior to a transaction will not be fatal. See Norwalk.

In Kennedy which is discussed later herein, the fact that the service provider worked essentially for free for 18 months was a factor in determining that payments were not for goodwill but for post-transaction services.

Normally last minute changes to the transaction that alter the allocation of purchaser price with personal goodwill injected are viewed with great suspicion by the IRS. Here, the transaction was changed, but there was no discussion of “personal goodwill” being discussed in the record. From day one, Pillsbury wanted the distribution agreement and Arnold’s contacts. The changes appear to be business driven.

Norwalk, 76 TCM (CCH) 208, 216, Dec. 52,817(M), TC Memo 1998-279.


Taracido Est., 72 TC 1014, 1023–1024, Dec. 36,293 (1979); Cullen, 14 TC 368, 372, Dec. 17,513 (1950); MacDonald, supra note 22 at 727.

In many circumstances, the legal obligation to retain and secure old client files can be a liability. While it may make it more likely the client will come back to the firm (goodwill) the files (or at least much of the files) pertaining to the client must be turned over to the client upon demand. If there is a personal relationship with a departed service provider, the files are often transferred.


As will be discussed later in this column, as the IRS argued here, a substantial overpayment in compensation of an employee shareholder may indicate that a transfer of corporate asset value was made to the shareholders being over compensated in by the Buyer. Conversely, a substantial underpayment of shareholder or other owners for future services by the Buyer may indicate intangible assets of the entity was overstated (presumably to obtain capital gains).


The estate attempted to argue the original valuation reported on the return was overstated. Between the original filing being an admission of value and a high burden of overcoming the admission and the court being unimpressed with the IRS valuation expert’s analysis and the analysis underlying the new lower value advocated by the estate, the court found the original value appropriate.


The author phrases this sentence with an “if” because a new process was going to be required because the prior source was mined out. A new process would be required to process the new source of ore to have a product.

Solomon, supra note 39.

Kennedy, 100 TCM (CCH) 268 (2010), Dec. 58,339(M), TC Memo 2010-206.


Kennedy, supra note 43.

The affirmative statements in Martin Ice Cream Co. and Howard that the individual was not subject to a noncompete or employment agreement should make it clear such is a requirement. Dr. Howard felt compelled to add an explanation point.

In re Prince, 104 TCM (CCH) 452, Dec. 59,225(M), TC Memo 2010-206.


This situation may be somewhat analogous to the analysis applied to the termination of nonlapse restrictions. See, for example, Martin Ice Cream Co., 110 TC 189, Dec. 52,624 (2011).

See, for example, Martin Ice Cream Co., 110 TC 189, Dec. 52,624.

Kennedy, supra note 43.

Kennedy, supra note 39.

Kennedy, supra note 43.

Kennedy, supra note 39.

Kennedy, supra note 43.

Newark Morning Ledger Co., Sct, 93-1 ustc ¶50,228, 507 US 546, 113 Sct 1670.


Martin Ice Cream Co., 110 TC 189, Dec. 52,624.

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