

PUBLICATION

Goodwill Owned by a Shareholder Can Provide Tax Planning Opportunities

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A recent U.S. Tax Court case reminds us that the personal goodwill owned by the principal shareholder/employee can provide significant tax planning opportunities. Generally, the sale of assets by a "regular" corporation (i.e., not a "pass through" entity, such as an 'S' corporation or a limited liability company) and the liquidation of the corporation to distribute the sales proceeds to the shareholder(s) generates exposure to two income tax events – the first being the sale of assets by the corporation when the tax is paid by the corporation; and the second being the liquidating distributions to the shareholders when the tax is paid by the shareholders.

In *Bross Trucking, Inc. v. Commissioner*, T.C. Memo. 2014-107 (June 5, 2014), the Internal Revenue Service assessed corporate income taxes, gift taxes and penalties on the alleged transfer of corporate goodwill to the trucking company's sole shareholder/employee, who allegedly, in turn, transferred it to his sons, who were organizing a new trucking corporation to avoid certain regulatory issues that their father's company was facing. Finding the goodwill of the corporation to be personal goodwill owned by the sole shareholder/employee, the Tax Court dismissed these assessments, noting that the shareholder/employee was free to transfer his personal goodwill to whomever he chose.

This case reminds us that, in structuring the sale of assets by a closely-held corporation (regardless of how much gross revenue the corporation might have), consideration of existing personal goodwill owned by a shareholder/employee is pertinent to corporate and shareholder tax planning. Generally speaking, personal goodwill should exist where (i) the shareholder/employee has close, personal relationships with the customers of the corporation, (ii) the shareholder/employee's personal efforts and client relationships have been important to and a direct factor in the success of the corporation, (iii) the corporation provides non-unique services or products to its customers, (iv) the shareholder/employee does not have an employment or similar contract with the corporation, and (v) the shareholder/employee does not have a covenant not to compete or similar contract with the corporation.

Each case must be evaluated on the basis of its unique facts and circumstances, but if all or some of the foregoing facts and circumstances exist, the allocation of a portion of the transaction value to the sale of personal goodwill owned by the shareholder/employee may result in the reduction in the overall income taxes on the transaction. Furthermore, the gain realized on the sale of personal goodwill by the shareholder may be taxed as a capital gain, at potentially lower rates than ordinary income.

Should you have any questions regarding these personally owned goodwill issues, or otherwise wish to discuss transaction related tax issues, please contact any one of the attorneys in the firm's Tax Group.