



The Big Deal About Personal Goodwill

Personal goodwill gets a lot of attention in cases of divorce. But it's often overlooked as a personal asset in purchase price allocations — a costly mistake.

A corporate employee or shareholder can own goodwill separately from the goodwill of the corporation if customers value the person — rather than the corporation — as the center of their commercial relationship. Separating personal goodwill from corporate goodwill means that the gain on liquidation is divided between assets owned by the corporation and assets owned by the shareholder. One level of tax can be avoided on the sale of the assets owned by the shareholder, thus reducing the total cost of liquidation. However, this tax benefit can be achieved only if appreciated assets — including personal goodwill — are kept out of the corporation.

Consider a corporation with a fair market value of \$5 million. Of that, tangible assets are valued at \$1 million and goodwill is valued at \$4 million. If half of that goodwill is valued separately as a shareholder's personal goodwill, the total tax savings is \$560,000, assuming a combined effective federal and state rate of 20 percent.

Courts Agree

Treating personal goodwill as a separate asset has been upheld in tax court, most notably in the case of Martin Ice Cream, a Haagen-Daz distributor. Majority owner Arnold Strassberg had longstanding relationships with customers, but no formal contract with Haagen-Daz. The court concluded that the valuable intangible assets embodied in the distribution agreement belonged solely to Strassberg.

The court stated “personal relationships of a shareholder-employee are not corporate assets when the employee has no employment contract with the corporation.”

The lesson here is to pay special attention to personal goodwill in purchase price allocations. Ownership of a little goodwill can make a big tax difference.

Want to find out more? Contact our office to discuss how personal goodwill might affect purchase price allocation.