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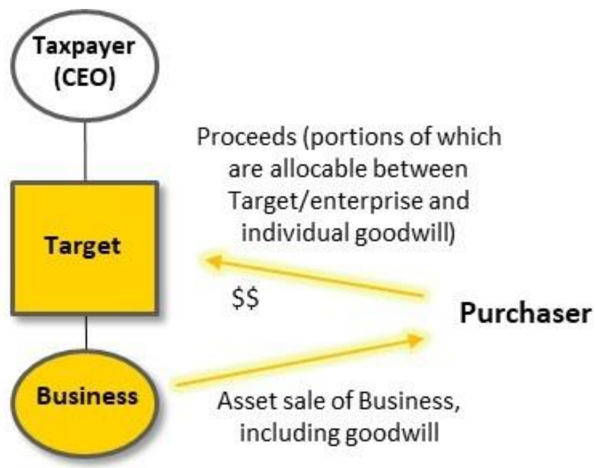
Technical Developments and Musings

Personal goodwill is a thing. In the sale of a closely-held business, the IRS sometimes pushes back on taxpayer assertions that a significant portion of the value in the business reflects the goodwill of an individual shareholder as opposed to the company itself. In a recent memorandum decision, however, the Tax Court sided with a taxpayer who claimed goodwill as a significant portion of the overall purchase price of a business that was sold. In *Huffman v. Comm'r,* TC Memo 2024-12, the court found that personal goodwill was created by the individual taxpayer/shareholder from relationships with key employees and customers during his time as CEO of the company. Notably, there was no formal employment agreement between the the individual and the company during this time; the individual entered into a non-compete agreement with the corporate purchaser that acquired the business in an asset sale; and under applicable state law governing the transaction, personal goodwill is an intangible asset capable of being owned by an individual. Perhaps most critically in this case, the parties to the transaction allocated a portion of the sales proceeds to the individual and obtained a third-party valuation to support the allocation between corporate, or enterprise, goodwill and personal goodwill. One reason that the IRS objected to the taxpayer assertion was that the individual taxpayer had not been formally listed as a party to the purchase agreement. The court did not find this fact persuasive, especially because the individual tax returns reflected the allocation. The court noted that "key employees may transfer their personal goodwill via employment contracts or noncompete agreements." To be sure, the court made adjustments to the valuation reported by the parties, concluding that some portion of the overall goodwill should have been reported by the corporate seller, thus reducing a portion allocable to the individual. But overall, this case illustrates that under the right facts, personal goodwill can be sold and the sale will be respected for US tax purposes, particularly where it is supported by a valuation and allocation agreements with a third-party purchaser.



IRS can recast Midco transaction to find transferee. In another memorandum decision, the Tax Court in *Meyer v. Comm'r,* TC Memo 2024-15, concluded that the IRS could recast a "Midco" transaction that occurred in 2000. The IRS asserted that a stock sale by the individual shareholder should be recast as though the company had sold its appreciated securities in an asset sale and then liquidated. Although most of the decision was focused on statute of limitations issues, the court agreed with the essential IRS recast position.

Capital contribution of shares is nonrecognition event. PLR 202406001 addresses the contribution of shares in a publicly traded company held by an executive and related trusts to the capital of such company. Citing a Supreme Court case from 1987 (*Fink*), the IRS ruled that the contributing shareholders would not recognize income from the contribution. A similar ruling was provided as to non-contributing shareholders (e.g., the public). (The taxpayer represented that the contribution was not part of a plan to periodically increase the proportionate share of any shareholder in the assets or earnings of the company.)