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Distinguishing and Planning around Individual Goodwill

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DISPOSABLE PERSONAL GOODWILL, FROSTY THE SNOWMAN, AND *MARTIN ICE CREAM* ALL MELT AWAY IN THE BRIGHT SUNLIGHT OF ANALYSIS

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TABLE OF CONTENTS

I. Introduction 170
II. Historical Background 172
  A. Pre-1986 Law 172
  B. Tax Reform Act of 1986 174
  C. Post-1986 Reaction 176
  D. Section 7704 178
III. Substantive Analysis.................................. 180
  A. Marketing Intangibles 184
    1. Transfer Pricing Rules.......................... 185
    2. *Martin Ice Cream* 191
    3. Taxpayer Duty of Consistency.................. 196
  B. Residual Goodwill Resides with the Business 202
IV. Corporate Tax Reform Implications.................... 209
V. Conclusion... 211

I. INTRODUCTION

The current rage in dispositional tax planning for closely-held C corporations is to bifurcate the sale transaction into two components comprising: (a) a sale by (i) the target C corporation's shareholders of their target C corporation stock or (ii) the target C corporation of its assets; and (b) a sale by some or all of the target C corporation's share-

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holders of "personal goodwill" associated with the business conducted by the target C corporation. The documented purchase price paid for the first component of the transaction (either the stock of the C corporation or the assets of the C corporation) is based on a fair market value determination that excludes consideration of the personal goodwill component of the transaction. If successful, this tax planning technique allows the selling shareholders to report only shareholder-level capital gain on the personal goodwill component of the transaction and allows the buyer to claim that this portion of the purchase price is allocable to an acquired intangible, i.e., goodwill, that is amortizable over fifteen years under § 197.[1] More specifically, from the selling shareholders' perspective, if the first component of the transaction involves a sale of the target C corporation's assets, the portion of the purchase price attributable to the personal goodwill component of the transaction does not bear the burden of a corporate level of taxation. From the buyer's perspective, if the first component of the transaction involves a purchase of the target C corporation's stock, the portion of the purchase price attributable to the personal goodwill component of the transaction is not capitalized into the stock.[2]

This planning is premised on the position that certain goodwill associated with the target C corporation's business can be, and is in fact, owned for tax purposes, by one or more shareholders. If all goodwill associated with the target C corporation's business activities were in fact owned for tax purposes by the target C corporation, then the personal goodwill component of the transaction is properly viewed as a sale by the target C corporation of such goodwill creating a corporate-level gain, followed by a distribution from the target C corporation to the shareholders, which in turn creates a shareholder-level gain.[3] If,

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1. I.R.C. § 197 (2006).
2. A premise for this planning (in addition to the premise that is the subject of this Article) is that the target C corporation's business has a fair market value that exceeds the fair market value of the assets shown on the target C corporation's balance sheet. Thus, some value is attributable to self-created goodwill (i.e., goodwill that has not been acquired and thus is not reflected on the balance sheet). *See* the discussion *infra* Part III. As a result, if the first component of the transaction is a sale by the target C corporation of its assets, the buyer generally would treat a portion of the purchase price as allocable to goodwill and thus to the purchase of an intangible asset amortizable under § 197 regardless of the presence of any personal goodwill. Accordingly, if the first component of the transaction is a sale by the target C corporation of its assets, the principal purported benefit from the personal goodwill planning technique would be the avoidance of corporate-level taxation. If the first component of the transaction was a sale of the target C corporation's stock, the purported benefits from the personal goodwill planning technique would include both the avoidance of corporate-level taxation and the acquisition by the buyer of an asset amortizable under § 197.
3. Howard v. United States, No. CV-08-365-RMP, 2010 WL 3061626 (E.D. Wash. Jul. 30, 2010), *aff'd* 448 F. App'x 752 (9th Cir. 2011). The transaction might also be viewed as a distribution by the target C corporation of the goodwill to the

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