Distinguishing and Planning Around Individual Goodwill

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Overview

Discuss planning opportunity to allow shareholders of closely held C corporation to maximize individual (preferential rate) capital gain on the sale of personal goodwill by restructuring the form in which the business operates.

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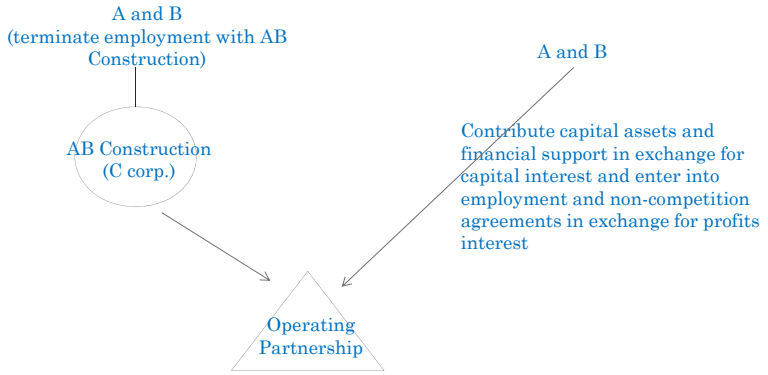
Hypothetical

- Shareholders A and B formed a C corporation to engage in the commercial construction business and have been actively involved in developing and growing the business for the past fifteen years.
- A and B have both been employed by the company and through the operation of the business have developed a respected reputation customer contacts, client relationships, industry know-how, relationships with suppliers and independent contractors.
- No employment agreement or non-compete exists between the shareholders and the company.
- After years of toiling in the construction business, A and B are contemplating the eventual sale of the business and would like to know what they can project to net on an after-tax basis, and what, if anything, they can do to maximize that amount.
- A and B have been under-compensated in many years, choosing to build the business as rapidly as possible.

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Planning Steps

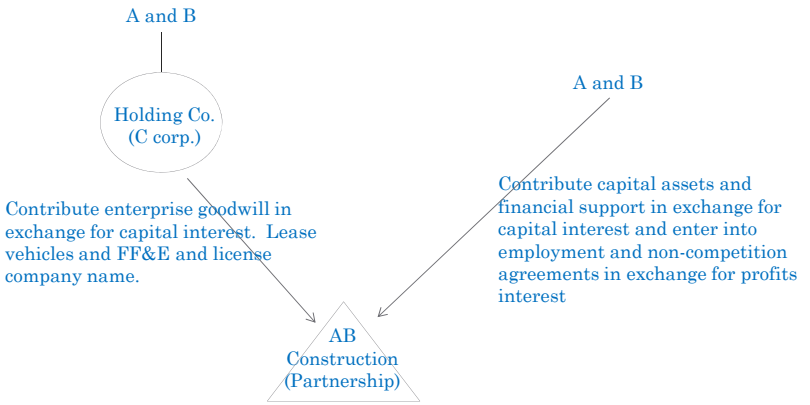
- Step 1 – Shareholders A and B terminate their employment with, and resign as directors of, the C corporation
- Step 2 – C corporation and former shareholders, A and B, form a partnership. A and B contribute (i) real property including warehouse used in the business, (ii) agree to provide their personal guarantee on construction bonds and (iii) individually owned know-how (and other intangible assets) in exchange for a capital interest. A and B enter into employment agreements and non-competition agreements with C corporation in exchange for a profits interest.



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Planning Steps

- Step 2 (cont.) - C corporation leases its vehicles and FF&E, and licenses the C corporation name to the partnership and receives a small capital interest attributable to the value of any goodwill contributed (e.g. workforce in place).
- Step 3 – AB Construction operates as a partnership going forward.



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