

RESTRICTIVE COVENANTS: PERSONAL GOOD WILL

by

Ross N. Cohen, Esq.
Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C.

I. What Is Personal Good Will?

Let us start with a definition of good will. Good will is an intangible asset that represents the market value of a going-concern business in excess of the market value of its tangible assets and identifiable intangible assets, such as patents, trademarks or contracts.

- A. Enterprise good will, or business good will, is manifested from characteristics specific and unique to a particular business enterprise.
- B. Personal good will attaches to a particular individual, rather than a business enterprise.

Based on the foregoing, in a commercial context, personal good will necessarily is the value of personal relationships valuable to a business enterprise that do not belong to the business enterprise.

II. What Are The Characteristics of Personal Good Will?

The judicial consideration, discussion and formulation of personal good will has largely occurred in the context of federal income tax cases.

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A. *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998)

The first tax case to deal with personal good will was reported 20 years ago - *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998). The Tax Court held, when a corporation has no employment or restrictive covenant contract with an employee (in this case, the owner), the employee's personal relationships are not corporate assets.

B. *Bross Trucking, Inc. v. Commissioner*, T.C. Memo 2014-107 (June 5, 2014)

In this recent Tax Court memorandum decision, the court concluded, generally speaking, personal good will should exist when:

- (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.

See Exhibit A, Baker Donelson Tax Alert, "Goodwill Owned by a Shareholder Can Provide Tax Planning Opportunities" by Ross N. Cohen.

C. *Duffy v. U.S.*, 117 AFTR 2nd 2016-xxxx (CA Fed Cir) 01/08/2016

In a case involving a refund claimed on an amended individual income tax return in connection with the reporting of proceeds received under a settlement agreement entered into with respect to the taxpayer/employee's employment discrimination claims against his employer, the Tax Court stated, "Several courts have held that the sale of goodwill occur 'only when the business or a part of it, to which the goodwill attaches, is sold.' *Elliott v. United States*, 431 F.2d 1149, 1154 [26 AFTR 2d 70-5473] (10th Cir. 1970); *see also Baker v. Comm'r of Internal Revenue*, 338 F.3d 789, 793 [92 AFTR 2d 2003-5640] 7th Cir. 2003) ("Goodwill cannot be transferred a part [sic] from the business with which it is connected.")"

III. Does Ala. Code §8-1-190 et seq., Restrictive Covenants, Apply to Personal Good Will?

A. Code §8-1-190(b)(3) states: "Except as otherwise prohibited by law, the following contracts are allowed to preserve a protectable interest:

* * * *

(3) One who sells the good will of a business may agree with the buyer to refrain from carrying on or engaging in a similar business and from soliciting customers of such business within a specified geographic area so long as the buyer, or any entity deriving title to the good will from that business, carries on a like business therein,

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subject to reasonable time and place restraints. Restraints of one year or less are presumed to be reasonable."

B. New Committee Comment

After discussing this question with him, the reporter for the Alabama Law Institute's Restrictive Covenant Drafting Committee asked for the submission of an entry for the Alabama Comment to Ala. Code §8-1-190. The author submitted:

"The exception for contracts which preserves a protectable interest in connection with the sale of good will of a business includes the sale of personal good will by an individual in connection with such sale of good will of a business or the other assets of such business."

C. Reduced to Writing

Ala. Code §8-1-192 states: "In order to be valid, any contract or agreement executed pursuant to this article shall be reduced to writing, signed by all parties, and be supported by adequate consideration."

See Exhibit B - Redacted Goodwill Purchase Agreement.

D. Presumptive Restriction Periods

Perhaps the most concerning change in the new law is the relatively short restriction periods presumed to be enforceable. Earlier Alabama cases sustained non-competition agreements with a term of five years that arose out of the sale of a business under the old law.

IV. Why Be Concerned With Personal Good Will When Selling a Business?

If personal good will exists, the allocation of the transaction value should include the allocation of a portion thereof to personal good will for the following reasons:

A. Avoidance of Corporate Creditors

Transaction value paid for personal good will should not be attachable by creditors of the corporation, short of piercing of the corporate veil or an alter ego theory.

B. Income Tax Planning

1. Avoidance of Double Income Taxation of 'C' Corporations

Transaction value paid for personal good will is not taxed to the corporation (a second income tax arising when the net-after-tax value is distributed in liquidation).

2. Conversion of Ordinary Income into Capital Gains

Transaction value paid for personal good will is reported as the sale of a capital asset, thus, potentially converting transaction value from ordinary income to capital gains. Transaction value paid for personal good will might not be subject to the Federal 3.8% net investment income tax.

See Exhibit C, Hesse, "Personal Goodwill and the Net Investment Income Tax," *The Tax Adviser*, May 2016, pp.340-343.

V. Securing the Acquired Good Will

If there is no personal good will and the transaction structure is an asset acquisition, be certain the acquisition agreement includes the good will (and the contracts embodying such) as an asset of the business enterprise that is being acquired, and that local law allows for such assignment (or have the employees subject to such non-assignable agreements sign new restrictive covenant agreements after the acquisition is effective.) If there is personal good will, regardless of the acquisition structure, be certain it is acquired from the individual who owns it in connection with the acquisition of the business to which it is connected.

For example, recently the Eighth Circuit Court of Appeals, in *Symphony Diagnostic Services No. 1 Inc. d/b/a MobilexUSA v Greenbaum*, No. 15-2294 (July 6, 2016), held an assignable, stand-alone non-compete agreement acquired in an asset sale could be enforced against the employee (who went to work for a competitor because the acquiror offered less pay and non-guaranteed fringe benefits) by the successor employer. The holding was grounded in the distinction between a personal services contract, like an employment agreement, which requires affirmative acts of the employee, and a non-compete agreement, which requires only that the employee refrain from certain actions. The former requiring the employee's consent, the latter, not. (Enforcement of non-compete agreements following a merger or stock sale is usually not an issue.) With respect to the old law in Alabama, see *Clark Substations LLC v. Ware*, 838 So.2d 360 (Ala. 2002), *Ex Parte Howell Engineering and Surveying, Inc.*, 981 So 2d 413 (Ala. 2006); and *Dawson v Ameritox, Ltd*, 2014 WL 31809. S.D. Alabama (2014).

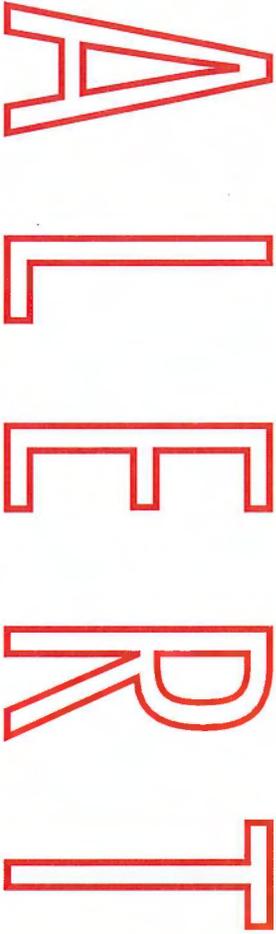
Exhibit A

Baker Donelson Tax Alert

"Goodwill Owned by a Shareholder Can Provide Tax Planning Opportunities"

Attached

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July 16, 2014

This is an advertisement.

Goodwill Owned by a Shareholder Can Provide Tax Planning Opportunities

By [Ross N. Cohen](#)

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](#).

Under requirements imposed by the IRS, we inform you that, if any advice concerning one or more U.S. federal tax issues is contained in this communication (including any attachments), such advice was not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another party any transaction or tax-related matter addressed herein.

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Exhibit B

Redacted Goodwill Purchase Agreement

Attached

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GOODWILL PURCHASE AGREEMENT

This GOODWILL PURCHASE AGREEMENT (the "Agreement") is made and entered into as of "_____" between "_____", a "_____" limited liability company (the "Buyer"), and "_____" (the "Seller").

RECITALS:

A. The Seller is a principal, key employee, and officer of "_____", a Georgia limited liability company (the "Company"), and such success as the Company has enjoyed and may enjoy in the future is expected to be due in large part to the valuable services heretofore performed for the Company by the Seller and to his continued efforts, energies and abilities.

B. The Seller has unique skills, knowledge, specialized training and experience that has enabled the Company to effectively and profitably conduct its business operations.

C. The Seller has strong personal relationships with the Company's customers and suppliers and he enjoys an excellent industry reputation.

D. It is the unique expertise, reputation and relationships of the Seller that gives the Company a significant portion of its intrinsic value.

E. Prior to the date hereof, the Seller has never entered into a covenant not to compete with the Company or any long-term employment agreements, which would give the Company the right to the future services of the Seller.

F. The Buyer, "_____" and "_____", have entered into a "_____" dated as of the date hereof (the "_____"), pursuant to which the Buyer is to acquire all of the membership interests in the Company.

G. The Buyer wishes to purchase from the Seller certain goodwill associated with the Company, which goodwill the Company acknowledges is owned by the Seller, and the Seller wishes to sell such goodwill to the Buyer, in accordance with the terms and provisions set forth in this Agreement. NOW, THEREFORE, in consideration of the premises and the terms and conditions hereinafter contained, the parties agree as follows:

1. Purchase and Sale of Goodwill.

(a) Purchased Goodwill. Subject to the terms and provisions hereof, as of the Closing Date, the Seller shall sell, assign, convey, transfer

and deliver to the Buyer, and the Buyer will accept and receive from the Seller, all of the Seller's right, title and interest in the Goodwill (as hereinafter defined) associated with the Company that is owned by the Seller.

(b) Goodwill Defined. When used in this Agreement, the term "Goodwill" means the intrinsic going concern value and positive reputation of the Company resulting from and attributable to the strong skills, expertise, knowledge, specialized training and experience of Seller as well as his strong relationships with customers and suppliers, an excellent industry reputation, and his personal abilities, personality and other individualistic qualities.

(c) Transfer of Goodwill. To facilitate and support the Seller's transfer of the Goodwill to the Buyer, the Seller also agrees to enter into an employment agreement (the "Employment Agreement") with the Buyer/Company. In addition, for the period through "_____", 20"____", Seller agrees: (i) with respect to the portion of the Goodwill attributable to the Seller's skills, expertise, specialized training, knowledge and experience, to mentor, train or teach designated employees of the Buyer and the Company; and (ii) with respect to the portion of the Goodwill attributable to the Seller's contacts or relationships with customers and suppliers, to provide introductions and generally facilitate a smooth transition of these relationships to the Buyer and the Company.

2. Purchase Price and Payment.

(a) Cumulative Purchase Price. The cumulative purchase price for the Goodwill (the "Cumulative Purchase Price"), prior to adjustment based upon the factors set forth in Section 2(c) below, shall be \$1,400,000, payable as provided in Section 2(b) below.

(b) Payment of Cumulative Purchase Price. The Cumulative Purchase Price shall be paid by the Buyer to the Seller as follows:

(i) On March 15 of each of 20"____", 20"____" and 20"____" (or such later date as determined under Section 2(e) below), the Buyer shall pay to the Seller the sum of \$400,000, subject to adjustment as provided in Section 2(c) below. There is no payment of the Cumulative Purchase Price during 20"____".

(ii) On January 1, 20"____" (or such later date as determined under Section 2(e) below), the Buyer shall pay to the Seller the sum of \$200,000, subject to adjustment as provided in Section 2(c) below; provided however, the 20"____" payment shall be based upon application of the Section 2(c) adjustment with the following modifications in the

application of Section 2(c): (A) as of June 30, 20"____" (in lieu of the end of the 2018 calendar year), and (B) the amount of \$200,000 shall be substituted for the amount of \$400,000.

(iii) Notwithstanding anything to the contrary, in the event that the Employment Agreement is (A) terminated by the Buyer or the Company "With Cause" (as hereafter defined), or (B) terminated by the Seller for any reason other than death, disability (as hereafter defined) or "Good Reason" (as hereafter defined), then Buyer will immediately thereafter owe no further obligations under this Agreement, including, without limitation, the payment to Seller of any unpaid portion of the Cumulative Purchase Price; provided however, the Seller's obligations under Sections 4 and 5 shall remain in full force and effect.

(iv) In the event that the employment of the Seller is terminated and, under the terms hereof, payments of the Cumulative Purchase Price continue under this Agreement, the calculation of the Cumulative Purchase Price following any such termination shall not include any management contracts that are entered into after the date of the Seller's termination from employment. It is the intent of the parties that management contracts that are entered into after the date of the Seller's termination from employment shall not increase or replace any lost management contracts in calculation of the adjustment of the Cumulative Purchase Price; but management contracts that are lost after the date of the Seller's termination from employment will be considered in the adjustment of the Cumulative Purchase Price.

(v) For purposes hereof, termination "With Cause" is defined as termination from employment of Seller as a result of:

A. Fraud, embezzlement, theft, dishonesty, or any misappropriation of any material amount of money or other assets or property of the Buyer, the Company or any of their Affiliates by the Seller;

B. Willful failure to perform, or gross negligence in the performance of, the Seller's duties and responsibilities to the Buyer, the Company and their Affiliates which remains uncured fifteen (15) business days after written notice of such failure specifying in reasonable detail the nature of such failure or negligence is given to the Seller by the Company;

C. The Seller's material breach of any of the terms of the Employment Agreement;

D. Conviction of, or plea of *nolo contendere* by, the Seller to a felony or other crime involving moral turpitude;

E. The Seller's material breach of his fiduciary duties as an officer, trustee, or director of the Buyer, the Company or any of their Affiliates;

F. The Seller's willful refusal or failure to carry out a lawful written directive of the Board of Managers of Buyer, which failure or refusal does not cease within fifteen (15) days after written notice of such failure is given to the Seller by the Buyer; or

G. The Seller's willful misconduct which has a materially adverse effect upon the business, interests or reputation of the Buyer, the Company or any of their Affiliates.

(vi) For purposes hereof, "Good Reason" is defined as termination from employment by Seller as a result of: (A) Buyer removing the Seller from the position of Chief Executive Officer of the Company without the Seller's consent (or failing to re-elect the Seller at any meeting of the Board of the Company held for the purpose of electing or re-electing officers of the Company) or (B) substantially changing the Seller's duties or the Seller's reporting responsibility to the Chief Executive Officer of the Buyer.

Notwithstanding the foregoing, the Seller will not be deemed to have terminated employment for Good Reason unless (x) the Seller provides the Buyer and the Company with written notice setting forth in reasonable detail the facts and circumstances claimed by the Seller to constitute Good Reason within thirty (30) days after the date of the occurrence of any event that the Seller knows or should reasonably have known to constitute Good Reason, (y) the Buyer or the Company fail to cure such acts or omissions within sixty (60) days following receipt of such notice, and (z) the effective date of the Seller's termination from employment for Good Reason occurs no later than sixty (60) days after the expiration of the cure period. Provided however, in the event that the Buyer or the Company had the right to terminate the Seller "With Cause," then the Seller shall not be deemed to have terminated from employment for "Good Reason."

(vii) For purposes hereof, "disability" is defined to be the Seller's inability to perform substantially all of the Seller's material duties and responsibilities under the Employment Agreement for (x) ninety (90) consecutive calendar days or (y) one hundred and twenty (120) total days during any period of three hundred and sixty-five (365) consecutive calendar days, as a result of any illness, injury, accident or condition of either a physical or psychological nature.

(c) Adjustment of Cumulative Purchase Price. For each payment set forth above in Section 2(b) above, the amount of such payment and, correspondingly, the Cumulative Purchase Price, shall be adjusted

based upon the maintenance/retention of the Acquired Contracts (as listed on **Exhibit A** hereto), as hereafter provided:

(i) In the event that there has been no Non-Maintenance Event from the Closing Date through the end of the prior calendar year, the Cumulative Purchase Price shall not be adjusted and the Seller shall receive a payment in the amount of \$400,000.

(ii) In the event that there has been a Non-Maintenance Event from the Closing Date through the end of the prior calendar year, then the Cumulative Purchase Price shall be adjusted and, for the applicable year, the Seller shall receive a payment equal to (1) \$400,000, reduced by (2) an amount equal to the product of (i) \$400,000, and (ii) the Loss Reduction Percentage.

For purposes of clarification, the 20"____" calendar year is deemed to commence on the Closing Date and end on December 31, 20"____".

Exhibit B sets forth an example of the operation of the calculation of each payment and adjustment of the Cumulative Purchase Price.

(iii) For purposes of calculating the adjustment to the payment and the Cumulative Purchase Price as utilized above, the following terms are defined as follows:

A. "Estimated Management Fee Amount" means the total management fee revenue, including incentives, received by the Company for the calendar year 20"____" for the Acquired Contracts; provided however, for the Related Party Courses (items 10 through 13 on Exhibit A), in place of the management fee revenue actually received by the Company, the management fee revenue shall be calculated by application of the management fee formula, including incentives, set forth in the applicable Related Party Management Agreement to be executed as part of this transaction (as if applied to the 20"____" calendar year). Within sixty (60) days after the end of 20"____", the Buyer shall calculate the Estimated Management Fee Amount and provide a detailed calculation thereof to the Seller. The Seller shall have the right and option to dispute such calculation and the procedures set forth in Sections 2(d) and 2(e) below shall be utilized to resolve any such dispute of such calculation.

B. "Loss Reduction Percentage" means the quotient of (A) the difference of (i) the lost management fee revenue of the Company, calculated on an annual basis, due to the occurrence of a Non-Maintenance Event occurring from the Closing Date through the end of the applicable calendar year, minus (ii) the management fee revenue recognized by the Company, calculated on an annual basis, due to new management

contracts entered into by the Company from the Closing Date through the end of the applicable calendar year and the consummation of such new management contracts is principally led by the Seller and/or the employees of the Company located at the headquarters of the Company in Birmingham, Alabama (not including new management contracts that are entered into primarily as a result of the efforts of the Buyer and subject to a maximum of two (2) new management contracts (on a cumulative basis from the Closing Date) to replace Acquired Contracts that are lost due to a Non-Maintenance Event), divided by (B) the Estimated Management Fee Amount. Notwithstanding the above, the Loss Reduction Percentage shall not be greater than one hundred percent (100%) or less than zero percent (0%) for any reason whatsoever. The Seller has have the right to designate the new management contracts to be utilized in the calculation.

C. "Non-Maintenance Event" means (i) the termination, non-renewal or modification of an Acquired Contract, (ii) the default in the payment of any amounts owed under any Acquired Contract to the Company, or (iii) any other breach, default or violation by a contracting party under an Acquired Contract other than the Company.

(d) Revenue Reports; Disputes.

(i) Within twenty (20) days following the end of each calendar year, the Buyer shall prepare and deliver to the Seller a revenue report of (A) all lost management fee revenue of the Company, calculated on an annual basis, due to the occurrence of a Non-Maintenance Event occurring from the Closing Date through the end of the applicable calendar year, and (B) all management fee revenue recognized by the Company, calculated on an annual basis, due to new management contracts entered by the Company from the Closing Date through the end of the applicable calendar year and the consummation of such new management contracts is principally led by the Seller and/or the employees of the Company located at the headquarters of the Company in Birmingham, Alabama (not including new management contracts that are entered into primarily as a result of the efforts of the Buyer and subject to a maximum of two (2) new management contracts (on a cumulative basis from the Closing Date) to replace Acquired Contracts that are lost due to a Non-Maintenance Event), which shall be prepared in good faith consistent with GAAP (each, a "Revenue Report").

(ii) Within ten (10) days after the Buyer's receipt of written notice from the Seller that the Seller accepts the Revenue Report, the Company shall pay to the Seller the payment due and owing to the Seller.

(iii) The Seller shall have the right and option, for a period of sixty (60) days from the delivery of a Revenue Report, to dispute

any elements of or amounts reflected on or calculated in the applicable Revenue Report. If the Seller does not deliver to the Buyer within the sixty-day dispute period a written notice of dispute that sets forth in reasonable detail the elements and amounts with which the Seller disagrees, the Revenue Report shall be deemed to have been accepted and agreed to by the Seller in the form in which it was delivered to the Seller and shall be final and binding upon the parties. If the Seller desires to dispute a Revenue Report, the process for selecting an Arbitrating Accountant and resolving the matter is set forth below.

(e) Arbitrating Accountant.

(i) If the parties are unable to resolve each element of the Dispute within the 30-day period after the Buyer's receipt of a Dispute Notice, the parties shall jointly engage a nationally recognized certified public accounting firm that has not performed accounting, tax or auditing services for the parties during the past three years as the arbitrator of the Dispute (the "Arbitrating Accountant"). If parties are unable to agree on the identity of the Arbitrating Accountant within 10 calendar days after any party makes a written request to appoint the Arbitrating Accountant, then the accountants designated by the parties shall jointly select an appropriate accounting firm to serve as the Arbitrating Accountant. The Arbitrating Accountant's function shall be to resolve each element of the Dispute that has not been resolved by the parties and to calculate the adjustment to the payment and the Cumulative Purchase Price as set forth in Section 2(c).

(ii) In connection with the resolution of the Dispute, the Arbitrating Accountant shall allow the parties to present their respective positions regarding the Dispute. The Arbitrating Accountant may, at its discretion, conduct a conference concerning the Dispute, at which conference the parties shall have the right to present additional documents, materials and other information and to have present their respective advisors, counsel and accountants. Any and all such documents, materials and information presented by each party to the Arbitrating Accountant shall be concurrently disclosed to other party. In connection with the resolution of the Dispute, there shall be no other hearings or oral examinations, testimony, depositions, discovery or other similar proceedings. Both parties shall make available to the other party and the Arbitrating Accountant, as the case may be, such documents, books, records, work papers, facilities, personnel and other information as such party or the Arbitrating Accountant may reasonably request to resolve the Dispute.

(iii) The Arbitrating Accountant shall as promptly as possible, and in any event within thirty (30) days after the date of its appointment, render its decision on each element in the Dispute in writing

to the parties, together with a calculation of the adjustment of the payment and the Cumulative Purchase Price. In resolving the Dispute, the Arbitrating Accountant shall be bound by the provisions of this Agreement. The Arbitrating Accountant's decision and the calculation of the adjustment to the payment and the Cumulative Purchase Price shall be final and binding upon the parties. The Arbitrating Accountant shall determine the proportion of its fees and expenses to be paid by each of the parties, based primarily on the degree to which the Arbitrating Accountant has accepted the positions of the respective parties with respect to those items in dispute.

3. Representations and Warranties Regarding the Seller and the Goodwill.

(a) All of the Goodwill is owned, and immediately prior to the Closing will be owned, by the Seller free and clear of all liens, encumbrances, claims, options, security interests, calls and commitments of any kind. Such Goodwill was developed by the Seller over an extended period of time and is transferred to the Buyer to be associated with the Company and to facilitate the reputation and intrinsic going concern value of the Company. The Seller has full legal right, power and authority to enter into this Agreement and to sell, assign and transfer the Goodwill to the Buyer and, on the Closing Date, the sale and assignment of the Goodwill to the Buyer hereunder will transfer to the Buyer valid title thereto, free and clear of all liens, encumbrances, claims, options, security interests and commitments of all kind.

(b) The Seller is not currently a party to any contract, employment agreement, non-compete agreement or any other contract or agreement or subject to any other restriction or subject to any restriction or condition contained in any permit, license, judgment, order, writ, injunction, decree or ward which, singly or in the aggregate, materially and adversely affects or restricts or is likely to materially and adversely affect or restrict the Goodwill or the Buyer's acquisition, use or enjoyment thereof.

(c) The execution and delivery of this Agreement by the Seller and the performance of the transactions contemplated herein have been duly and validly authorized by the Seller, and the agreement to sell the Goodwill pursuant to the terms and conditions of this Agreement is a legal, valid and binding obligation of the Seller, enforceable against him in accordance with its respective terms subject to bankruptcy, insolvency, reorganization, moratorium and similar laws of general application relating to or affecting creditor's rights and general equity principles.

(d) To the best of Seller's knowledge, Seller is not aware of any present facts or any pending₃ events, which would prevent the Buyer

from realizing the economic benefits associated with the Goodwill in the same manner as presently enjoyed by the Seller.

4. Restricted Activities. In exchange for good and valuable consideration hereunder, the Seller agrees that restrictions on the Seller's future activities are necessary to protect the Goodwill, and other legitimate interests of the Buyer, the Company and their Affiliates:

(a) For the period through December 31, 20"____" (the "Non-Competition Period"), the Seller shall not, directly or indirectly, whether as owner, partner, officer, director, manager, investor, consultant, agent, employee, co-venturer or otherwise, alone or in association with any other Person, engage in any activity that involves a Competing Business anywhere in the United States. Restricted activity includes without limitation accepting employment or a consulting position with any Person who is, or at any time through June 30, 20"____" has been, a customer of the Buyer, the Company or any of their Affiliates. For the purposes of this Section 4, the business of the Buyer, the Company and their Affiliates shall include, without limitation, all Products and the Seller's undertaking shall encompass all items, products and services that may be used in substitution for Products.

(b) The Seller further agrees that, during the Non-Competition Period, the Seller will not, directly or indirectly, hire or attempt to (i) hire any Person who is (or within the six (6) months prior to such date has been) an employee of the Buyer, the Company or any of their Affiliates, assist in such hiring by any Person, encourage any such employee to terminate his or her relationship with the Buyer, the Company or any of their Affiliates, excluding general solicitations not specifically directed at any such persons (provided that the Seller is not directly involved in such solicitations in any way), or (ii) solicit or encourage any Person who is (or within the six months prior to such date has been) a customer or vendor of the Buyer, the Company or any of their Affiliates to terminate its relationship with them, or, in the case of a customer, conduct with any Person any business or activity which such customer conducts or could conduct with the Buyer, the Company or any of their Affiliates.

(c) At all times, the Seller further agrees that the Seller shall not, whether in writing or orally, malign, denigrate or disparage the Buyer, the Company or their Affiliates or subsidiaries, their respective predecessors and successors, or any of their respective current or former products, directors, officers, employees, shareholders, partners, members, customers, agents or representatives of any of the foregoing, with respect to any of their respective past or present activities, or otherwise publish (whether in writing or orally) statements that tend to portray any of the aforementioned in an unfavorable light.

5. Enforcement of Covenants. The Seller acknowledges that the Seller has carefully read and considered all the terms and conditions of this Agreement, including the restraints imposed upon the Seller pursuant to Section 4 hereof. The Seller agrees without reservation that each of the restraints contained herein is necessary for the reasonable and proper protection of the Goodwill and other legitimate interests of the Buyer, the Company and their Affiliates; that each and every one of those restraints is reasonable in respect to subject matter, length of time and geographic area; and that these restraints, individually or in the aggregate, will not prevent the Seller from obtaining other suitable employment during the period in which the Seller is bound by these restraints. The Seller further agrees that the Seller will never assert, or permit to be asserted on the Seller's behalf, in any forum, any position contrary to the foregoing. The Seller further acknowledges that, were the Seller to breach any of the covenants contained in Section 4 hereof, the damages to the Buyer, the Company and their Affiliates would be irreparable. The Seller therefore agrees that the Buyer and the Company, in addition to any other remedies available, shall be entitled to preliminary and permanent injunctive relief against any breach or threatened breach by the Seller of any of said covenants, without having to post bond. The parties further agree that, in the event that any provision of Section 4 hereof shall be determined by any court of competent jurisdiction to be unenforceable by reason of its being extended over too great a time, too large a geographic area or too great a range of activities, such provision shall be deemed to be modified to permit its enforcement to the maximum extent permitted by law.

6. Closing. The Closing will take place simultaneous with the consummation of the transaction under the "_____ " Agreement (the "Closing Date") to be effective as of the close of business on such date. On the Closing Date, the Seller shall deliver to the Buyer a Bill of Sale and Assignment of Goodwill in the form attached as **Exhibit C**, duly executed by the Seller, conveying to the Buyer good title to the Goodwill.

7. Definitions. Words or phrases which are initially capitalized or are within quotation marks shall have the meanings provided in this Section 7 and as provided elsewhere herein. For purposes of this Agreement, the following definitions apply:

(a) "Affiliates" means all Persons and entities directly or indirectly controlling, controlled by or under common control with the Company, where control may be by either management authority or equity interest. For the avoidance of doubt, Affiliates does not include any unrelated _____ portfolio companies that are not directly or indirectly connected with the business of the Company.

(b) "Competing Business" means any business, company or entity, or division within, or subsidiary of, any business, company or entity, which is (x) involved in providing management, development, construction, or operational services, or any other form of consulting or advisory services, to "_____", "_____", "_____", or "_____" or (y) any substantially related business that the Buyer, the Company or any of their Affiliates is engaged in or has made plans to engage in, prior to June 30, 201____; except the term "Competing Business" shall not include the Employee Companies listed in Section 2(b) of the Employment Agreement.

(c) "Person" means an individual, a corporation, an association, a partnership, an estate, a trust and any other entity or organization, other than the Buyer, the Company or any of their Affiliates.

(d) "Products" mean all products planned, researched, developed, tested, manufactured, sold, licensed, leased or otherwise distributed or put into use by the Buyer, the Company or any of their Affiliates, together with all services provided or planned by the Buyer, the Company or any of their Affiliates, prior to June 30, 20 "_____".

8. Benefit. This Agreement shall inure to the benefit of and be binding upon the Buyer, the Company and the Seller, their respective successors, executors, administrators, heirs and permitted assigns.

9. Severability. If any portion or provision of this Agreement shall to any extent be declared illegal or unenforceable by a court of competent jurisdiction, then the remainder of this Agreement, or the application of such portion or provision in circumstances other than those as to which it is so declared illegal or unenforceable, shall not be affected thereby, and each portion and provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

10. Waiver; Amendment. No waiver of any provision hereof shall be effective unless made in writing and signed by the waiving party. The failure of either party to require the performance of any term or obligation of this Agreement, or the waiver by either party of any breach of this Agreement, shall not prevent any subsequent enforcement of such term or obligation or be deemed a waiver of any subsequent breach. This Agreement may be amended or modified only by a written instrument signed by the Seller and an expressly authorized representative of the Company.

11. Notices. Any and all notices, requests, demands and other communications provided for by this Agreement shall be in writing and shall be effective when delivered in person or deposited in the United States mail, postage prepaid, registered or certified, and addressed to the Seller at his

last known address on the books of the Buyer or the Company or, in the case of the Company, at the Buyer's principal place of business, attention of the Chief Executive Officer, or to such other address as either party may specify by notice to the other actually received.

12. Entire Agreement. This Agreement constitutes the entire agreement between the parties and supersedes and terminates all prior communications, agreements and understandings, written or oral, with respect to the terms and conditions of the matters set forth herein.

13. Headings; No Construction Against Drafter. The headings and captions in this Agreement are for convenience only and in no way define or describe the scope or content of any provision of this Agreement. No provision of this Agreement or related document will be construed against or interpreted to the disadvantage of any party hereto by any court or other governmental or judicial authority by reason of such party having or being deemed to have structured or drafted such provision.

14. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be an original and all of which together shall constitute one and the same instrument.

15. Governing Law. It is the intent of the parties hereto that all questions with respect to the construction of this Agreement and the rights and liabilities of the parties hereunder shall be determined in accordance with the laws of the State of Delaware, without regard to principles of conflicts of laws thereof that would call for the application of the substantive law of any jurisdiction other than the State of Delaware.

16. Enforcement Expenses. In the event any party elects to incur legal expenses in connection with any legal or equitable proceeding to enforce, defend or interpret any provision of this Agreement, as between it and any other party, the prevailing party will be entitled to recover from the other party such legal expenses, including reasonable attorneys' fees, costs and necessary disbursements, in addition to any other relief to which such party may be entitled.

17. Exhibits. Each Exhibit (when and as executed) is incorporated by reference into this Agreement and will be considered a part hereof as if set forth herein in full.

18. Third Party Beneficiaries. Nothing contained in this Agreement will be construed as giving rise to any right to enforce its provisions to any Person not a party to this Agreement under any legal theory.

19. Waivers and Consents. Any waiver of any provision of this Agreement and any consent given hereunder must be in writing signed by the party sought to be bound. The waiver by any party of breach or violation of any provision of this Agreement will not operate as, or be construed to constitute, a waiver of any subsequent breach or violation of the same or any other provision hereof.

20. Severability. In the event any provision of this Agreement is held to be invalid, illegal or unenforceable for any reason and in any respect, such invalidity, illegality or unenforceability will in no event affect, prejudice or disturb the validity of the remainder of this Agreement, which will be and remain in full force and effect, enforceable in accordance with its terms.

21. Survival of Representations, Warranties and Covenants. The representations, warranties and covenants of the Seller contained in this Agreement shall not be superseded by or merged into the Bill of Sale and Assignment of Goodwill and shall survive the execution and delivery of the Bill of Sale and Assignment of Goodwill.

IN WITNESS WHEREOF, the parties hereto have executed this Goodwill Purchase Agreement as of the date first above written.

" _____ ", a " _____ "
limited liability company

By: _____

Name: _____

Title: _____

EXHIBIT C

BILL OF SALE AND ASSIGNMENT OF GOODWILL

This BILL OF SALE AND ASSIGNMENT OF GOODWILL is executed and delivered as of "_____", _____, 20____ by "_____" (the "Seller") in favor of "_____", a "_____" limited liability company (the "Buyer").

RECITALS:

A. The Seller is a principal, key employee and officer of "_____", a "_____" limited liability company (the "Company"), and such success as the Company has enjoyed and may enjoy in the future is expected to be due in large part to the valuable services heretofore performed for the Company by the Seller and to his continued efforts, energies and abilities.

B. The Seller has unique skills, knowledge, specialized training and experience that has enabled the Company to effectively and profitably conduct its business operations.

C. The Seller has strong personal relationships with the Company's customers and suppliers and he enjoys an excellent industry reputation.

D. It is the unique expertise, reputation and relationships of the Seller that gives the Company a significant portion of its intrinsic value.

E. The Seller has not ever entered into a covenant not to compete with the Company or any long-term employment agreements, which would give the Company the right to the future services of the Seller.

F. The Buyer, "_____", "_____", "_____" and "_____", have entered into a "_____" dated as of the date hereof (the "Agreement"), pursuant to which the Buyer is to acquire all of the membership interests in the Company.

G. The Seller and Buyer have entered into a Goodwill Purchase Agreement dated as of the date hereof (the "Goodwill Purchase Agreement"), pursuant to the terms and provisions of which the Seller has agreed to sell, assign and transfer to the Buyer, and the Buyer has agreed to purchase from the Seller, all the Goodwill owned by the Seller.

H. The Goodwill Purchase Agreement provides that as a condition to the consummation of the transactions contemplated thereby, the Seller will execute and deliver this Bill of Sale and Assignment of Goodwill and to provide post closing services to the Buyer, all as set forth in the Goodwill Purchase Agreement.

I. The Seller now desires to sell, assign, and transfer the Goodwill to Buyer, as provided in the Goodwill Purchase Agreement.

J.

NOW, THEREFORE, for and in consideration of the premises and the agreements herein set forth and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Seller agrees as follows:

1. Sale and Assignment. The Seller does hereby sell, assign, transfer, convey and deliver to Buyer, its successors and assigns forever all of the Seller's right, title and interest in, to and under the Goodwill, to have and to hold the Goodwill unto itself and its successors and assigns, to its and their own use, forever.

2. Survival of Representations, Warranties and Covenants. The representations, warranties and covenants of the Seller contained in the Goodwill Purchase Agreement shall not be superseded by or merged into this Bill of Sale and Assignment of Goodwill and shall survive the execution and delivery of this Bill of Sale and Assignment of Goodwill.

3. Further Assurances. The Seller hereby covenants and agrees that the Seller will execute, acknowledge, deliver, file and record such further certificates, amendments, instruments and documents, and will do all such other acts and things as may be required by law or as may be reasonably necessary or advisable to carry out the full intent and purposes of this Bill of Sale and Assignment of Goodwill.

4. Successors and Assigns. This Bill of Sale and Assignment of Goodwill and the covenants and agreements contained in it shall be binding upon the Seller and his heirs, personal representatives, successors and assigns and shall inure to the benefit of the Buyer and its successors and assigns.

5. Defined Terms. Defined terms in this Bill of Sale and Assignment of Goodwill (unless otherwise defined herein) shall have the meaning provided in the Goodwill Purchase Agreement.

6. Governing Law. THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF " _____ ", WITHOUT REGARD TO ITS PRINCIPLES OF CONFLICTS OF LAWS.

IN WITNESS WHEREOF, this Bill of Sale and Assignment of Goodwill has been executed by the Seller effective as of the date first written above.

SELLER:

" _____ "

Exhibit C

Personal Goodwill and the Net Investment Income Tax

The Tax Adviser

Attached

Personal Goodwill and the Net Investment Income Tax

By: Christopher W. Hesse, CPA

PREVIEW

- In the sale of a business, the goodwill associated with the business, if attributable to an owner of the business, may be treated as an asset sold by the owner.
- Understand the treatment of the gain from the sale of personal goodwill of a C corporation for net investment income tax purposes.
- The passive activity rules support the position that gain from the sale of personal goodwill associated with a C corporation is not subject to the net investment income tax.

In the sale of a C corporation, goodwill in many cases is the property of a shareholder rather than of the corporation. The Tax Court has found this to be the case where the success of the corporation depended on the shareholder's ability and reputation and there was no noncompete agreement between the shareholder and the corporation. The shareholder must recognize the income from the sale of the goodwill as capital gain.



However, a related question arises: Is that gain subject to the net investment income tax under Sec. 1411? Many commentators seem to assume that it is. However, a careful analysis of the net investment income tax and passive activity loss regulations should lead to the opposite conclusion for most sales of personal goodwill. This article looks at the circumstances under which goodwill can be considered a shareholder's property and why the income from the sale of goodwill developed by the personal efforts of the individual should not be subject to the net investment income tax.

Sales of Goodwill

Double-taxation arises upon the sale or distribution of C corporation assets in a C corporation liquidation or upon the sale or distribution of an S corporation's assets subject to the built-in gains (BIG) tax in an S corporation liquidation. The corporation pays tax on the sale or distribution of the assets. The shareholders pay tax again on the amount of their liquidation distribution less their stock basis.

However, if intangible assets associated with a sale are properly characterized as the property of the shareholders, the double-taxation is reduced. For example, upon a sale of a business, a portion of the consideration might be for the selling shareholder's covenant not to compete or to contractually bind the individual to perform consultation services to the purchaser of the business. These types of arrangements will result in ordinary income (not capital gain) to the selling shareholder rather than income to the corporation.

A number of court cases have addressed the issue of whether, in the sale

of a corporation, goodwill was the property of the selling corporation or of the selling shareholder. In *Martin Ice Cream Co.*,¹ the Tax Court reviewed the value of assets split off from a corporation in preparation for a sale. The court divided the intangible assets into two groups. One group, including assets such as business records of the business, was the property of the corporation. The other group, the intangibles assets, consisting of an oral contract made by one of the corporation's two shareholders with the corporation's primary supplier and that same shareholder's relationships with customers of the business, was found to be assets of that shareholder. A factor in the decision was the lack of any noncompete agreement between the shareholder and the corporation. The issue was how to determine the value of a split-off corporation that did not qualify for nonrecognition of corporate gain under Sec. 355. The IRS asserted that the value of the corporation split-off included goodwill. The court found that the goodwill belonged to the shareholder and should not be included as an asset of the corporation in determining the corporation's value.²

In *Norwalk*,³ the Tax Court similarly found that no corporate goodwill existed because the professional accounting practice of the corporation depended upon the key employees of the corporation. There were no noncompete agreements between the corporation and the shareholders, and the court found that the personal ability and reputation of the shareholders were the assets of the shareholders and not assets of the corporation passing to the shareholders in the liquidation of the corporation, labeling these assets as personal goodwill.

Although the payment for personal goodwill is either made (or treated as being made) to the individual owner or owners of a corporation, its status as an asset of the owner or owners is obscured because its sale is directly associated with the sale of the corporation or its assets. Evidence that goodwill is a personal rather than a corporate asset is supported if the shareholders negotiate the sale of goodwill separately from the negotiation by the corporation of the sale of its assets.⁴ Additional support is found if the shareholders' personal goodwill is not divided pro rata among the shareholders in the same percentage as the ownership of the stock, but rather each shareholder receives separate consideration for the sale of his or her own personal goodwill.

The sale of personal goodwill generates gain. A sale of personal goodwill may accompany the sale of a business through a sale of a corporation's stock or the sale of a corporation's assets. A shareholder of an S corporation may also benefit from the sale of personal goodwill if that S corporation selling assets is otherwise subject to the BIG tax under Sec. 1374. Personal goodwill, which is held by the shareholder, is not subject to the BIG tax because it is not a corporate asset held at the effective date of the S election.

Net Investment Income Tax

Although it has been established that the sale of a shareholder's personal goodwill may generate capital gain to the shareholder, a related question is whether that capital gain is net investment income for purposes of the net investment income tax. Sec. 1411 was enacted in 2010,⁵ and it imposes a 3.8% tax on net investment income (over

1. *Martin Ice Cream Co.*, 110 T.C. 189 (1998).

2. Note that the shareholder's taxation was not before the Tax Court, however. The court did not have occasion to discuss the character of the income as payments for services or payments for a capital asset. See *Kennedy*, T.C. Memo. 2010-206.

3. *Norwalk*, T.C. Memo. 1998-279.

4. *Kennedy*, T.C. Memo. 2010-206. The court stated that allocation to goodwill of 75% of the total consideration paid was a tax-motivated afterthought that occurred late in the negotiations.

5. Patient Protection and Affordable Care Act, P.L. 111-148, as amended by the Health Care and Education Reconciliation Act of 2010, P.L. 111-152.

certain thresholds) of individuals, estates, and trusts, effective for tax years beginning in 2013. Net investment income includes net gains from the disposition of property except to the extent attributable to a trade or business that is not a passive activity or a trade or business of trading in financial instruments or commodities.⁶ Consequently, the default is that all capital gain is net investment income unless an exception applies.

Sec. 1411 includes an exception for the disposition of active interests in partnerships and S corporations.⁷ However, to the extent that the net gain from such a disposition would have been subject to net investment income tax had the entity sold its property immediately before the disposition of the ownership interest, the disposition gain is subject to net investment income tax.⁸ The exception applies only to partnership and S corporation interests, however. No exception is available for dispositions of stock in a C corporation.

The activity of a C corporation is not a trade or business with respect to the individual shareholder. Regardless of the level of participation of the shareholder in the C corporation's business, the gain on the sale of C corporation stock is net investment income. Unless the corporation can elect S status prior to

Evidence that goodwill is a personal rather than a corporate asset is supported if the shareholders negotiate the sale of goodwill separately from the negotiation by the corporation of the sale of its assets.

the shareholder's sale of stock, the gain on the sale of stock is subject to net investment income tax. Likewise, the liquidation gain to the shareholder of a C corporation is subject to net investment income tax.

If personal goodwill is sold in conjunction with the sale of a business in the corporate form, at first glance, it would seem appropriate to treat the gain from its sale as gain from the sale of an investment asset and include it in net investment income. However, a closer look reveals that the gain should be excluded, based on how the passive activity rules

apply to income from personally created intangibles and to income from personal service activities.

Analysis

With respect to the net investment income tax, the important characteristic of personal goodwill is that it is a personally developed intangible asset for purposes of the passive loss rules. Under those rules, the gross income of an individual from intangible property, "such as a patent, copyright, or literary, musical, or artistic composition, if the taxpayer's personal efforts significantly contributed to the creation of such property" is excluded from the definition of passive activity gross income.⁹ Personal goodwill does not on its face seem like patent, copyright, etc., but it is an intangible that was personally developed by the seller. The provision excluding from passive activity income any gross income that is derived by a creator of an intangible is under the temporary regulation heading of "Other items specifically excluded."¹⁰ Therefore, gain from the sale of personal goodwill is not passive activity income and, consequently, it should be excluded from net investment income under Sec. 1411(c)(1)(A)(iii), so it is not subject to the net investment income tax.

6. Sec. 1411(c)(1)(A)(iii).

7. Sec. 1411(c)(4).

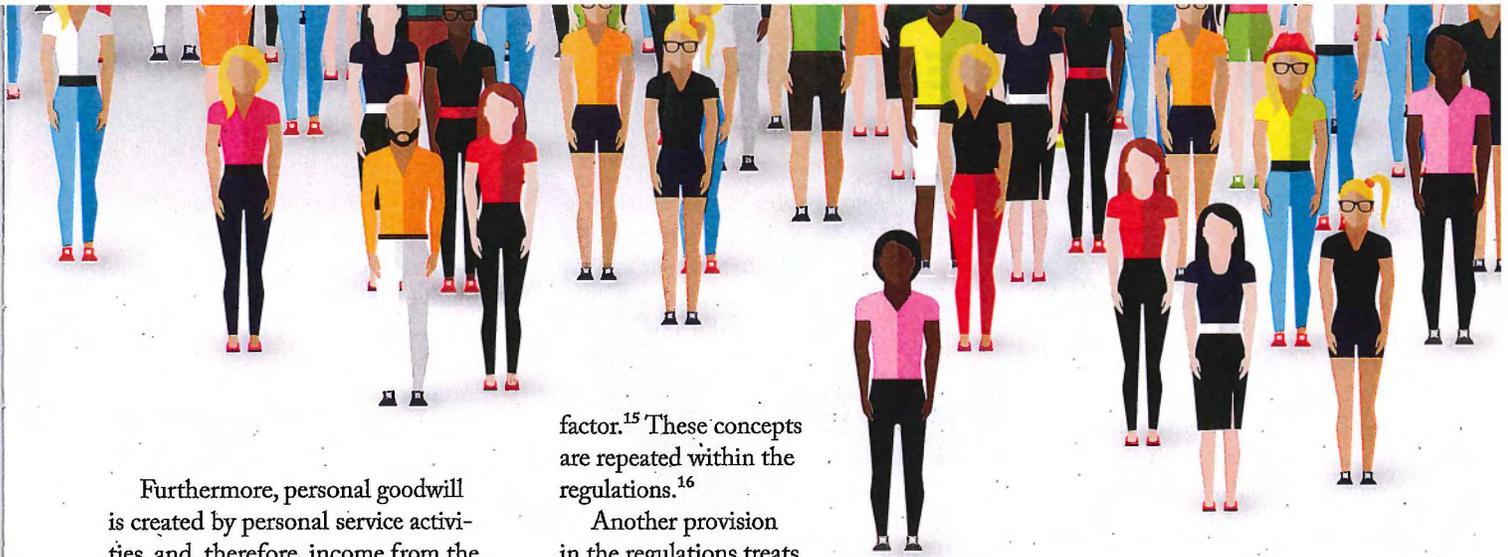
8. Sec. 1411(c)(4)(A).

9. Temp. Regs. Sec. 1.469-2T(c)(7)(i).

10. Id.

EXECUTIVE SUMMARY

- When a C corporation is sold, goodwill in many cases is the property of a shareholder rather than of the corporation. The Tax Court has found this to be the case where a business's success depended on its key employees' ability and reputation and there was no non-compete agreement between them and the corporation.
- Although the net investment income tax generally excludes from net investment income disposition of active interests in partnerships and S corporations, the same treatment does not extend to C corporation stock.
- Net investment income also does not include net gains from property held in a trade or business (other than trading in financial instruments or commodities) that is not passive with respect to the taxpayer.
- Because gain from the sale of personal goodwill is income from a personally developed intangible asset that is not passive income, and, generally, income from personal service activities is not passive, the gain from the sale of personal goodwill should not be subject to the net investment income tax.



Furthermore, personal goodwill is created by personal service activities, and, therefore, income from the disposition of goodwill should not be treated as passive. The starting point in determining whether gains are subject to the net investment income tax is Sec. 1411(c)(1)(A)(iii), which taxes all net gains from the disposition of property other than property held in a trade or business (other than the trade or business of trading in financial instruments or commodities) that is not passive. To be excluded, therefore, the gain has to be from a trade or business, and the taxpayer has to be “not passive” with respect to that trade or business. Taxpayers are directed¹¹ to Sec. 469 for the meaning of the term “passive activity”: any activity that involves the conduct of any trade or business in which the taxpayer does not materially participate.¹²

Earned income is not taken into account in computing the income or loss from a passive activity.¹³ Earned income for this purpose includes wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered.¹⁴ A personal service activity is one that involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting or any other trade or business in which capital is not a material income-producing

factor.¹⁵ These concepts are repeated within the regulations.¹⁶

Another provision in the regulations treats income from personal service activities as material participation income. Individuals are deemed to materially participate in an activity if it is a personal service activity and they actually materially participated in the activity for any three tax years preceding the current tax year.¹⁷

Income from a business in which capital is not a material income-producing factor is not currently defined. However, the pre-1982 Internal Revenue Code included Sec. 1348, which limited the tax rate applicable to earned income. “Earned income” was not defined in Sec. 1348, but the section referred to Sec. 911(b). The provision in Sec. 911(b) was moved and reworded into Sec. 911(d) in 1981.¹⁸

Keep in mind the environment under which the passive activity rules were promulgated in the Tax Reform Act of 1986.¹⁹ They were designed to prevent taxpayers from artificially creating passive income. Most, if not all, income associated with more than an incidental level of personal services is classified or recharacterized as not passive, while deductions and losses associated with taxpayers’ passive activities are limited. The IRS was empowered to issue regulations to prevent taxpayers from structuring income-producing activities to produce

passive income that could offset passive losses.²⁰ These recharacterization provisions, included in regulations under Sec. 469 to prevent the creation of passive income, work to reduce the taxpayer’s exposure to net investment income tax.

Taken together, the provisions excluding personal service income and income from intangible property from passive income indicate that property developed by the personal efforts of the individual does not generate passive income for the individual. It should not matter that such goodwill, associated with the individual, enhanced the value of the business being conducted by a C corporation. ■

Contributor

Christopher Hesse is a principal in the National Tax Office of CliftonLarsonAllen LLP in Minneapolis. He is also a member of the AICPA Tax Executive Committee and a former chair of the AICPA S Corporation Technical Resource Panel. For more information about this article, contact thetaxadviser@aicpa.org.

11. Sec. 1411(c)(2)(A).

12. Sec. 469(c)(1).

13. Sec. 469(e)(3).

14. Sec. 911(d)(2)(A).

15. Temp. Regs. Sec. 1.469-5T(d).

16. See Temp. Regs. Sec. 1.469-2T(c)(4).

17. Temp. Regs. Sec. 1.469-5T(a)(6).

18. Economic Recovery Tax Act of 1981, P.L. 97-34, §111.

19. Tax Reform Act of 1986, P.L. 99-514.

20. S. Rep’t No. 99-313, 99th Cong., 2d Sess., at 731 (1986).