

Business Transaction Marketplace

Information about Business Valuations, Acquisitions, & Sales

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The Problem with an Asset Sale Involving a C Corp

There are two taxable deal structures when businesses are sold – an Asset Sale and a Stock Sale. Buyers generally prefer an Asset Sale for three primary reasons: a) the Buyer gets a “step up” in tax basis; b) the Buyer can pick and choose what assets to purchase; and c) the Buyer does not inherit the Seller’s contingent liabilities (as with a Stock Sale).



These are all good for the Buyer. But for the Seller, an Asset Sale can create a large tax problem if the selling entity is a C-Corp. Unlike S-Corps and Partnerships (both “pass-thru” entities), C-Corps pay tax at the entity level up to 35% for federal taxes, plus any state or local taxes. So if the assets of a C-Corp are sold, a “double tax” situation occurs. Tax is paid once at the corporate level, and again at the individual level when remaining assets are distributed to the C-Corp shareholders.

The *Marketplace Alert* section of this Issue points out that in 2006, there were over 2.4 million C-Corp tax returns filed in the US. Buyers who want to purchase the assets of these companies (particularly those that have low tax bases and high values), will force Sellers of these companies to deal with the dreaded double tax. The following articles discuss how allocating part of transaction price to personal goodwill can mitigate this double tax problem.

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Allocation of Transaction Price to Personal Goodwill



Businesses can generally be categorized by growth stage: Entrepreneurial Stage, Managerial Stage, and Professional Stage. At the Entrepreneurial Stage, and to some extent the Managerial Stage, the success and value of the business is largely dependent upon a few individuals (the founder in most cases), who have either the technical know-how behind the product or service; or, the person with the ability to bring in the business (i.e. the rainmaker).

Without these key individuals, the business would likely have little value. In other words, “the goodwill goes home at night”.

So when the transaction price for a business is looked at closely, there are really two sellers: 1) the business entity, and 2) an individual selling his or her *personal goodwill*. This creates a tax savings opportunity; here’s an example that quantifies the impact.

Assume that the marginal federal and state income tax rate for a C-Corp is 40%. Further assume that the marginal federal and state capital gains tax rate for an individual is 20%. For every \$1 of transaction price allocated to personal goodwill, instead of being subject to tax at the C-Corp level, the overall tax savings is 32¢. This is because the \$1 allocated to personal goodwill does not get double taxed.

So when the success of a business is largely dependent upon one or more individuals, an allocation of transaction price to personal goodwill can create significant tax savings when there is an Asset Sale involving a C-Corp.

Identifying and Quantifying Personal Goodwill

The Martin Ice Cream tax court case in 1998 (110 TC 189) has become the landmark case dealing with personal goodwill as part of a business transaction price. The particular facts surrounding the case are helpful in identifying personal goodwill in other business transactions. You can read a detailed description of the case in an article that appeared in *IBBA News* titled "Martin Ice Cream Co. vs. Commissioner: A Case for Personal Goodwill", by clicking on the link below.



[Read more . . .](#)

What the Martin Ice Cream case did not provide was a methodology to quantify personal goodwill. Every business transaction is unique. The amount allocated to personal goodwill is dependent upon two things: 1) the facts and circumstances surrounding the business, and 2) the deal structure. An article that appeared in *The Tax Advisor* titled "Separating Personal Goodwill and Business Goodwill" provides a methodology to quantify personal goodwill. You can access this article by clicking the link below.

[Read more . . .](#)

Marketplace Alert



In fiscal year 2006, the IRS reported that over 228 million tax returns were filed in the U.S. Excluding sole proprietorships (Schedule C taxpayers), S Corps, Partnerships, and C Corps are the returns most filed by business enterprises.

Here were the numbers of returns filed (in thousands): S-Corps, 3,825; Partnerships, 2,773; and C-Corps, 2,454. Since there are approximately 8,300 public companies (assuming all are C-Corps), means there were still over 2.4 million privately owned companies filing C-Corp tax returns.

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- June 3, 2007: Succession Planning: Exit Strategies for the Privately Held Business Owner (8 hr. Course)
- June 4, 2007: Tax Boot Camp for the Merger & Acquisition Professional (8 hr. Course)
- June 5, 2007: Maximizing the Value of the Privately Held Company (8 hr. Course)
- June 6, 2007: Working Capital and Other Balance Sheet Concepts in Negotiating and Closing Transactions (M&A Source Panelist)
- June 8, 2007: The Three-Legged Stool of Business Transaction Deal Structuring (Workshop)

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