

Goodwill hunting

How goodwill can affect both your company's and your personal value **Interviewed by Matt McClellan**

What impact would your departure have on the performance of your business? Would it suffer or could you be easily replaced? The skills you've honed and the reputation you've earned are all part of the good will you have accumulated.

The value of goodwill is a concept that may confuse many business owners. Richard Squar, the tax and litigation support director of Glenn M. Gelman & Associates, says the confusion stems from the proper way to categorize and value intangible assets.

"In many cases, goodwill is only attributable to the business," Squar says. "However, in some cases goodwill may be attributable to the owner personally — which creates major financial implications for business sales, taxes and the separation of marital assets in divorce proceedings. Imagine paying more in a divorce on the value of your business for your personal goodwill."

Those implications are handled differently from state to state. In fact, some states have yet to adopt a hard, fast rule for personal goodwill, instead judging each situation on a case-by-case basis.

Smart Business learned more from Squar about how goodwill affects you and your business.

What is goodwill?

There are tangible assets and intangible assets in every company. Tangible assets are things like cash, accounts receivable, inventory and equipment — things you can quantify. Next, you calculate net tangible assets, which are tangible assets minus liabilities.

Then there are intangible assets. They are the difference between the value of the business and those net tangible assets. That is commonly called goodwill. Goodwill can include patents, customer lists, brand names, leases, proprietary software.

Does every business have personal goodwill as a part of its value?

Usually you'll find that personal goodwill will be in professional practices, like accountants, doctors or attorneys. In those cases, personal goodwill is linked to the business owner, and usually something that can't be transferred to a buyer of the company. It's a function of the owner's rep-



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utation, skills and personal efforts.

Personal goodwill also creates a problem in divorce cases, because personal goodwill has a major effect on the future earning capacity of a company. Look at what cash flow is supposed to happen in the future for a company, project that and then mathematically determine what the present value is. If goodwill is a function of the future earning capacity and future earnings are what are used to compute what a spouse gets as an award for maintenance or alimony, some states recognize that as a 'double dip.' The business owner is saying, 'Why should you count this personal goodwill in my business's value and give my spouse a portion of that and count that same thing again to give a portion for alimony?' One is a split of assets due to the value of the business, and the other is a split of income.

How is valuation of goodwill determined?

Some states say personal goodwill is not separable from business goodwill. For personal goodwill, and usually for professionals, courts look at the person's age, health, ability to demonstrate past earnings and reputation for judgment, skill and knowledge. Those factors are seen frequently in

case law. They would also compare personal success to others in his field depending on the type of practice and how long he or she has been in business.

Take the solo doctor, for example. He or she could easily say, "These people are coming here because of me, not because of some business value. They are being referred to me because of my skills."

How can appraisers separate personal and enterprise/business goodwill?

It's a difficult concept, so techniques and methods are all over the board. Some appraisers will just offer their professional opinion without a lot of calculations. Others will compute total goodwill and take a percentage as personal.

Most appraisers look at elements that are not connected to the business. It's easier to see the difference between personal and business goodwill in professional fields like a CPA, attorney or doctor. It's more difficult in commercial business, with businesses that have a board of directors, president and a brand name. State courts don't lean too much toward those businesses. They see them less and less as having separable personal goodwill.

How does goodwill affect the value of a business?

Sometimes during the sale of businesses, there may be intangible, valuable parts of the business that the seller can't transfer. In other words, if I were to sell my business to somebody new, not all my clients would accept the new owner. To the extent that some clients would want to stay with me and wouldn't transfer to the buyer, that could be considered part of my personal goodwill.

We've seen some tax planners separate personal goodwill in the sale of a business to try to capture long-term capital gain tax rates rather than ordinary income rates.

A prospective purchaser might say they're only going to buy the parts of the business from which they can get repeat customers. If the seller has repeat customers the purchaser would lose to the seller, they likely won't want to move forward. <<

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