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The Big Value — and Tax Savings — of Personal Goodwill

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Thomas D. Phelan

Tom Phelan, a partner in Troutman Pepper's Tax Practice Group, was quoted in the December 19, 2024 *Financial Planning* article, "The Big Value — and Tax Savings — of Personal Goodwill."

Sellers should consult a tax expert early and often to consider every possible rule or implication from this form of asset transaction, according to Kupfer and Thomas Phelan, a partner with the Troutman Pepper Hamilton Sanders law firm who advises clients on M&A, reorganizations and cross-border deals.

Goodwill represents the difference between the total purchase price for a company in a deal and the market value of the firm's assets minus liabilities. Within that umbrella, personal goodwill adds up to an especially important part of the purchase-price allocation for advisory practices that are "closely held corporations" with their value "very much targeted on the personal relationships of Jim Smith and his technical expertise," Phelan noted in an interview.

In a personal transaction that distinguishes those assets from the goodwill of the corporation, the buyer "ends up in the same position" with "a deal that allows them to get a step up and a depreciable asset," he said. The sellers, however, steer clear of paying taxes at both the corporate and individual levels in the personal goodwill transaction.

"If they're operating out of a C-corporation, then I think the personal goodwill transaction seems potentially more appealing," Phelan said. "The seller benefit is they get the capital gain and they don't have to pay double tax. … You can strip a lot of value potentially out of the corporation, thus avoiding the double tax."

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Such nuances with personal goodwill deals point to the necessity of engaging with experts well in advance about topics like the terms of prior employment contracts, the structure of a deal and the resulting taxes, according to Phelan. He has "often seen it come up" when the owners of a closely held corporation find out about their future bills to Uncle Sam under a deal after signing the letter of intent with a buyer, he said.

"You want to talk to someone on the tax front early — ideally in the LOI process when it's initially being negotiated," Phelan Said. "There's an LOI, they're buying the business and then they realize, 'Oh shoot, we're going to get hit with a double tax on this.'"

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