

M&A Nuggets: Take It Personally - It's Goodwill

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By Glenn D. Solomon



A common quandary facing sellers taxed as C corporations is the double tax that will result from a sale structured as an asset purchase — one level of tax to the corporation on the sale of its assets and a second level of tax to the stockholders on distribution of the net proceeds from the sale. This double tax can equal close to 50% of the total purchase price. The best way to avoid the double tax is to convince the purchaser to engage in a stock sale. That, however, is not always possible. In that case, serious consideration should be given to whether a portion of the purchase price can be allocated to the personal goodwill of the seller's owners, as opposed to company goodwill.

Any part of the purchase price allocated to personal goodwill will be subject to one level of tax. An additional benefit to the seller is that amounts allocated to personal goodwill are subject to capital gains tax rates. From the purchaser's viewpoint, it can deduct amounts attributed to personal goodwill over 15 years, which is the same result as with amounts allocated to company goodwill.

Personal goodwill is the goodwill of the individual owner of the seller that results from the person's unique expertise, reputation or relationship with vendors and/or customers. Personal goodwill does not exist in every business. Before agreeing to an allocation to personal goodwill, an analysis should be made to determine the likelihood that the allocation will withstand any challenge by the Internal Revenue Service. The most quoted personal goodwill legal case involved a distributor of ice cream products who sold part of his business to Häagen-Dazs. In that case, the court recognized that the most valuable asset of the business was the owner's business relationships with the business's customers; the success of the business depended entirely on the owner. Another important factor was that the owner did not have a non-compete agreement. The court held that the owner, not the company, sold his assets to Häagen-Dazs. If the factors identified by the court in the Häagen-Dazs case apply and personal goodwill exists, a seller can obtain a significant tax benefit. That would be a very nice dessert on top of the main event of the business sale.