

Goodwill and Section 1031 Exchanges Do Not Mix Well

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The goodwill of a business can never be exchanged for the goodwill of another business. Goodwill is not like kind property. Treasury Regulation 1.1031(a)-2(c)(2) makes that crystal clear, providing:

The goodwill or going concern value of a business is not of a like kind to the goodwill or going concern value of another business.

Deseret Management Corp. v. Commissioner, 112 AFTR 2d 2013-5530 (Ct. Fed. Cl. 2013), illustrates the fact that goodwill may exist and be intermixed with business assets being transferred in an exchange under IRC Section 1031. The existence of goodwill creates taxable boot.

Whether goodwill exists is a question of facts and circumstances; the possible existence of goodwill cannot be ignored. The issue comes down to expert valuation testimony — does it exist and what value should be assigned to it?

In the *Deseret Management Corp.* case, the taxpayer exchanged the assets of a radio station, including the FCC license, for the assets of another radio station. It followed all of the personal property grouping rules. The Service disputed whether goodwill was properly accounted for and the value assigned to goodwill, which would be treated as taxable boot.

The value of the assets being exchanged was \$185 million. The parties stipulated that the hard assets had a value of a little over \$8.2 million. The taxpayer argued that the remaining \$176.8 million or so was mostly, if not all, properly allocable to the FCC license. The Service, on the other hand, asserted that a big chunk of the \$176.8 million should be allocated to goodwill or going concern value.

A battle of the experts ensued. Fortunately, for the taxpayer, its experts were more credible than the government's experts. Only a small amount of the value attributable to the assets was found to account for goodwill. In fact, the court concluded the amount of goodwill or going concern value was "at most, negligible."

The moral to the story is simple. In an exchange of business assets, you need to carefully consider whether goodwill or going concern value exists. An otherwise tax deferred exchange may be taxable. Careful

thought is required. Also, a qualified appraisal is warranted in order to avoid unwanted surprises down the road.

Deseret Management Corp. serves as a good reminder that goodwill or going concern value could be lurking among the business assets being transferred in a Section 1031 exchange.

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