State Law and Tax Treatment of Personal Goodwill, Part 1

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Although goodwill is common to almost every business acquisition, there is often confusion about goodwill owned by an individual — personal goodwill. In the first installment of a two-part article, Wood and Beck review the state property law and federal tax law relevant to personal goodwill cases.

The ownership of assets is fundamental to commerce, yet precisely who owns what may be unclear in complicated transactions. Sometimes that is not a worry. In the acquisition of a portfolio of real estate assets owned by several limited liability companies, a buyer may be less concerned with which LLC owns which parcel, as long as he gets clear title to each. In corporate acquisitions, the same phenomenon can occur with a parent and its subsidiaries.

A developer or investor normally knows which entity owns which asset. But there are times when ambiguity should be expected, particularly with assets that are intangible and self-created. That helps to explain the frequent head-scratching among taxpayers and their advisers concerning the topic of personal goodwill. Who owns the goodwill associated with a business?

In most cases, the answer is simple. The business owns goodwill, whether by purchasing or creating it. It is important to distinguish *acquired* from *developed* goodwill. If one buys an operating business, that purchase usually includes all goodwill. Thereafter, the buyer owns it and will hopefully improve and cultivate it.

The ownership of goodwill may be less clear, however, for private companies dominated by a single individual. Consider a service enterprise in which an incorporated physician or lawyer is the primary service provider. Some tax cases have addressed situations in which the question of ownership has either not been asked or has been inadequately answered. One must address this question before evaluating tax consequences.

Unfortunately, many taxpayers and their advisers seem confused by the concept of personal goodwill. Some are mired in the case law, in which the courts examine factual nuances but fail to determine ownership before touring the tax law. One can sidestep cases in which one company simply buys a business from another. In those cases, the goodwill goes from one company to the other.

Similarly irrelevant are cases in which a founding individual attributes goodwill to himself but signs an employment agreement (sometimes years before with his own company) that assigns all goodwill he creates or develops to the company. That person no longer owns personal goodwill, if he ever did. Equally irrelevant are cases in which the selling individual signs *both* an employment agreement *and* a covenant not to compete with the buying entity.

Factual Paradigms

To address how the tax law deals with personal goodwill, one must begin with the question of who owns what, which comes down to state law. State law is fundamental to property rights and ownership. Ownership under state law is often the difference between success and failure in tax cases.

Suppose Dr. Smith engages in a medical practice through ServiceCo, his wholly owned C corporation. Smith has built up and expanded ServiceCo and now wishes to sell it. The buyer is willing to pay $10 million for everything, including all the goodwill Smith claims to own personally. Two agreements are negotiated: an asset purchase agreement between the buyer and ServiceCo and a personal goodwill purchase agreement between the buyer and Smith. The consideration for each agreement is $5 million.

Tax practitioners will readily see that this bifurcated structure has starkly contrasting results. When Smith sells his personal goodwill, he sells a capital asset and has a capital gain. In contrast, the payment to ServiceCo is subject to two taxes: The asset sale is taxed at the corporate level, and the distribution to Smith is taxed to him.

The attractiveness of a single capital gain tax on the individual owner explains some of the confused (if not downright bad) case law surrounding personal goodwill. But the fact that there is some bad case law involving ill-planned and ill-executed attempts to argue the applicability of the personal goodwill doctrine does not mean that the doctrine is not viable. Indeed, the case law is strong and vibrant, as the most well-known case makes clear.

In *Martin Ice Cream v. Commissioner*,[1] Arnold Strassberg sold the assets of Strassberg Ice Cream Distributors Inc. and his personal goodwill to Haagen-Dazs Co. Inc.[2] The Tax Court recognized that Strassberg's personal goodwill was a transferable, intangible asset he alone owned and sold.[3] *Martin Ice Cream* seems unassailable on its facts, but several recent decisions can be read to suggest that its application is quite narrow.[4]

The facts are key, and many fact patterns plainly cannot support a *Martin Ice Cream* result. However, recent cases, including *H&M Inc. v. Commissioner*,[5] show the continuing vitality of transfers of personal goodwill in business transactions. One aspect of the personal goodwill issue that is often overlooked is the pivotal role of state law.

Throughout federal tax law, state law determines underlying property rights. Goodwill is an intangible asset, and defining it can be difficult. Some states have taken significantly different positions concerning its content. The states have also taken different approaches to whether goodwill can accrue to an individual. California, one of the most important commercial states, recognizes an expansive concept of personal goodwill.

Relationship Between State and Federal Law

The Internal Revenue Code assesses taxes by reference to property rights and the ownership of assets and income.[6] However, property rights are generally established by *state* rather than federal law.[7] The code taxes property transactions, but local laws regulate and define them.[8]

For example, the code allows a taxpayer to deduct a bad debt,[9] but local commercial law determines when a debt becomes worthless.[10] Thus, in the seminal case *Morgan v. Commissioner*,[11] the Supreme Court considered whether Elizabeth Morgan had a general power of appointment over two trusts. Under federal tax law, the trusts would be included in her estate only if she had a general power that gave her full dominion over the property.[12] Although Morgan's power was a special power under Wisconsin law, it was consistent with a federal general power.

[1] 110 T.C. 189 (1998), *Doc 98-9572*, *98 TNT 52-8*.

[2] *Id.* at 191.

[3] *Id.* at 208-209.

[4] *Kennedy v. Commissioner*, T.C. Memo. 2010-206, *Doc 2010-20736*, *2010 TNT 184-13*; *Howard v. United States*, No. 2:08-cv-00365 (E.D. Wash. 2010), *Doc 2010-17126*, *2010 TNT 148-15*, *aff'd*, No. 10-35768 (9th Cir. 2011), *Doc 2011-18431*, *2011 TNT 168-16*; *Muskat v. United States*, No. 06-cv-00030 (D.N.H. 2008), *Doc 2008-7567*, *2008 TNT 68-20*, *aff'd*, 554 F.3d 183 (1st Cir. 2009), *Doc 2009-2051*, *2009 TNT 19-55*; *Solomon v. Commissioner*, T.C. Memo. 2008-102, *Doc 2008-8540*, *2008 TNT 75-16*. *But see H&M Inc. v. Commissioner*, T.C. Memo. 2012-290, *Doc 2012-21314*, *2012 TNT 200-8* (following *Martin Ice Cream*).

[5] T.C. Memo. 2012-290 (rejecting the IRS's characterization of payments as for the sale of assets by the corporate entity rather than for the sale of personal goodwill by the owner).

[6] *See* Boris Bittker, ''The Federal Income Tax and State Law,'' 32 *Sw. L.J.* 1075, 1075-1076 (1979) (''So simple a matter as the deduction of a worthless debt under IRC section 166(a)(1) on the ground that the taxpayer's claim against the debtor is barred by the statute of limitations depends on the length of the state's limitations period, the effect of a seal or recordation, the effect on the statute of limitations of an oral acknowledgment of the debt, and other factors that are governed by state law and vary from one state to another. Before the federal tax effect of a transaction can be determined, a host of threshold determinations of this type are almost always required''). *But see* Timothy R. West, ''*Drye v. United States*: Limiting the Traditional State Right to Define Property,'' 69 *UMKC L. Rev.* 909 (2001) (finding that a recent Supreme Court case limited the ability of states to define property in the context of a federal tax lien).

[7] *See, e.g.*, *Commissioner v. Dunkin*, 500 F.3d 1065, 1069 (9th Cir. 2007), *Doc 2007-20192*, *2007 TNT 171-46*; *Dotson v. Commissioner*, T.C. Summ. Op. 2004-164, at *4-*5 (2004), *Doc 2004-22886*, *2004 TNT 232-7*; *Witcher v. Commissioner*, T.C. Memo. 2002-292, at *6, *Doc 2002-26347*, *2002 TNT 229-6*. *Cf.* 28 U.S.C. section 1652 (''The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply'').

[8] *See* Keeva Terry, ''Separate and Still Unequal? Taxing California Registered Domestic Partners,'' 39 *U. Tol. L. Rev.* 633, 640-646 (2008) (reviewing authorities supporting the notion that the test of taxability is ownership determined by state law); *Cf. Bd. of Regents v. Roth*, 408 U.S. 564, 577 (1972) (''Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law'').

[9] *See* Bittker, *supra* note 6, at 1075-1076 (using a similar example).

[10] *See* section 166 (allowing a deduction for worthless debts).

[11] 309 U.S. 78 (1940).

[12] *See* section 2041.

Morgan's estate claimed the power was special while the IRS claimed it was general. To resolve that conflict, the Court concluded that state law granted Morgan the right to appoint the trusts but that federal tax law designated that power as general. Accordingly, the power was general and the trusts were included in her estate.

Morgan remains widely cited.[13] For example, in *Van v. Commissioner*,[14] in evaluating whether the taxpayer had beneficial ownership of real property, the Tax Court cited *Morgan* and California Evidence Code section 662, which presumes beneficial ownership from title.[15]

State Law in the Code

In some cases, Congress intends for a uniform national principle to define the interest being taxed.[16] If not, state property law may fulfill its traditional role under federalism as the foundation that defines rights left unstated in federal law.[17] As professor Boris Bittker once noted, the code's approach toward a national principle can be categorized three ways.[18]

The code can supersede a state law right and replace it with federal tax law definition. An example is attribution under section 318,[19] which makes state law ownership irrelevant.[20] Conversely, the code can incorporate state law, as in section 368(a)(1)(A), which defines a reorganization to include one effected under state law.[21]

In most situations, however, the code takes neither extreme in its reference to state law.[22] Goodwill falls into that third and largest category. Moreover, there is little guidance on how to identify the goodwill held by an individual, much less a business. In fact, no section of the code even defines goodwill.[23]

Of course, the code does *refer* to goodwill, and those references provide some boundaries. Because goodwill is not listed in section 1221, it is a capital asset.[24] Section 197 controls the amortization of some intangibles, including goodwill.[25] Further, the code suggests that this acquired intangible has a finite life span (amortizable over 15 years) and that it can be valued (its adjusted basis at acquisition is amortized).[26] Section 865 provides foreign and domestic sourcing rules for personal property, including a special rule for goodwill.[27]

Plainly, none of those references to goodwill identify when a taxpayer owns it. Consequently, the code relies on state law to define the events creating taxable income. When the code uses legal terms without explicitly adopting or supplanting state law definitions, it will generally follow state law definitions.[28]

Federal Income Case Law

Even before *Martin Ice Cream*, federal tax law recognized that goodwill *can* accrue to an individual rather than a business. When Strassberg sold his intangible to Haagen-Dazs representing ''personal relationships with the supermarket owners

[13]*See, e.g.*, *Fortunato v. Commissioner*, T.C. Memo. 2010-105, at *26, *Doc 2010-10617*, *2010 TNT 92-7* (''Thus, *Morgan* stands for the proposition that if we determine that State law creates a property interest or a right thereto, we are not necessarily bound by the formalities of State law; we may look through to the substance''); *see also United States v. Mitchell*, 403 U.S. 190, 197 (1971) (''In the determination of ownership, state law controls'').

[14]T.C. Memo. 2011-22, *Doc 2011-1895*, *2011 TNT 19-10*.

[15]*Id.* at *7.

[16]*Cf. Int'l Paper Co. v. Ouellette*, 479 U.S. 481 (1987) (discussing a form of preemption in which a federal statute has preemptive scope); *Dickerson v. New Banner Inst.*, 460 U.S. 103, 119 (1983) (discussing a principle of statutory interpretation that Congress did not intend for federal law to depend on state law).

[17]*Cf. Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) (''The historic police powers of the States were not to be superseded by [federal law without] the clear and manifest purpose of Congress'').

[18]Bittker, *supra* note 6, at 1081 (''(a) provisions of the Internal Revenue Code explicitly imposing a uniform national definition on a familiar state law term, (b) provisions of the Code that explicitly subordinate national uniformity to state law, and (c) the broad intermediate area . . . in which the Code uses legal terms without explicitly indicating whether they are to retain their customary local sense or be given a uniform national interpretation'').

[19]*See* section 318; Bittker, *supra* note 6, at 1082 (using a similar example).

[20]*See* section 318.

[21]*See* section 368(a)(1)(A); Bittker, *supra* note 6, at 1083 (using a similar example).

[22]Bittker, *supra* note 6, at 1082.

[23]Section 7701, which includes miscellaneous definitions, does not include an entry for goodwill.

[24]*See* section 1221 (establishing an exclusive list of assets that are not capital assets).

[25]*See* section 197(d)(1)(A).

[26]*See* section 197(a) (amortizing the adjusted basis of section 197 intangibles ratably over 15 years).

[27]*See* section 865 and 865(d)(3).

[28]Bittker, *supra* note 6, at 1084 (''It rarely infuses them with a national meaning, but instead ordinarily defers to state law by employing the terms as abbreviated ways of designating the events and relationships that create taxable income, deductions, and other tax consequences. Indeed, the only alternative to these shorthand expressions would be detailed descriptions in the Code of the underlying facts triggering federal tax consequences, a practice that might increase the clarity of the Code but would require a far wordier statute than Congress has ever seen fit to enact'').

and managers,"[29] it was his alone and did not belong to his corporation.

Despite the seminal status of *Martin Ice Cream*, personal goodwill has been claimed by business people as varied as doctors, accountants, and insurance salespersons.[30] At the same time, the courts have acknowledged that even when an individual does create personal goodwill, he can transfer the goodwill to the business through an employment contract or covenant not to compete.[31] That mechanism is crucial.

In *Martin Ice Cream*, Strassberg never entered into a covenant not to compete or even an employment agreement.[32] He never transferred his goodwill to the business. Similarly, in *H&M*, the individual had no agreement with his corporation to prevent him "from taking his relationships, reputation, and skill elsewhere."[33] The Tax Court in *H&M* therefore found that a portion of the sale price was allocable to personal goodwill.[34]

In contrast, in *Howard v. United States*,[35] the taxpayer transferred his goodwill to his corporation through an employment agreement and covenant not to compete. Howard could not sell goodwill because it belonged to the corporation. The result in these cases is obvious, and it is surprising that taxpayers pursue them. Perhaps there is confusion over who owns what.

Moreover, given the allure of the tax benefits, taxpayers may try to fit their facts into the personal goodwill mold. Some taxpayers remain adamant that their facts were just like those in *Martin Ice Cream* even though it is clear under state law that they did not own any personal goodwill. An employment agreement and a covenant not to compete may make it crystal clear that the figurehead claiming personal goodwill did not own it. These unfortunate cases taint the entire field and prejudice taxpayers with demonstrable personal goodwill.

Defining Goodwill

Called "varying and often contradictory,"[36] goodwill is notoriously hard to define.[37] It can include business goodwill,[38] customer goodwill (an asset representing the preference of customers), and personal goodwill (representing personal skill, reputation, and relationships that accrue to an individual).

Business Goodwill

Goodwill is often described as the premium paid for a corporation over the value of its assets.[39] That goodwill is also described as enhanced earning power.[40] For example, in *Sanders v. Jackson*,[41] the court referred to goodwill as the remainder of the fair market value less the book value of the tangible assets.[42]

As defined by the Financial Accounting Standards Board, goodwill is "an asset representing the economic benefits arising from other assets acquired in a business combination . . . that are not individually identified and separately recognized."[43] Business goodwill is a placeholder for

[29]*Martin Ice Cream*, 110 T.C. at 206.

[30]*See, e.g., Norwalk v. Commissioner*, T.C. Memo. 1998-279, *Doc 98-24175*, *98 TNT 147-5*; *Wyler v. Commissioner*, 14 T.C. 1251 (1950); *MacDonald v. Commissioner*, 3 T.C. 720, 727 (1944); *Longo v. Commissioner*, T.C. Memo. 1968-217. In *Howard v. United States*, Dr. Larry Howard, a dentist, might have accrued personal goodwill (although he transferred it via an employment agreement and covenant not to compete). *Howard*, No. 10-35768 (9th Cir. 2011) (unpublished); *see further Schilbach v. Commissioner*, T.C. Memo. 1991-556, at *11.

[31]*Howard*, No. 10-35768 (9th Cir. 2011) (unpublished).

[32]*Martin Ice Cream*, 110 T.C. at 207 ("Ownership of these intangible assets cannot be attributed to petitioner because Arnold never entered into a covenant not to compete with petitioner or any other agreement — not even an employment agreement — by which any of Arnold's distribution agreements with Mr. Mattus, Arnold's relationships with the supermarkets, and Arnold's ice cream distribution expertise became the property of petitioner").

[33]*H&M*, T.C. Memo. 2012-290, at *22.

[34]*Id.* at *25 (noting that it did not need to determine the exact allocation given that the owner was not a party to the litigation with the IRS).

[35]No. 10-35768 (9th Cir. 2011) (unpublished).

[36]Alicia Brokars Kelly, "Sharing a Piece of the Future Post-Divorce: Toward a More Equitable Distribution of Professional Goodwill," 51 *Rutgers L. Rev*. 569, 577 (1999) (citations omitted) ("Characterized as the most intangible of intangibles, the concept of goodwill is so elusive that courts and commentators have struggled for more than a century simply to define goodwill. Varying and often contradictory definitions abound").

[37]*See, e.g.*, Darian M. Ibrahim, "The Unique Benefits of Treating Personal Goodwill as Property in Corporate Acquisitions," 30 *Del. J. Corp. L.* 1, 7 (2005); Kelly, *supra* note 36, at 577-582; J. Thomas Oldham, *Divorce, Separation, and the Distribution of Property*, para. 10.03 (1987); Carmen Valle Patel, Note, "Treating Professional Goodwill as Marital Property in Equitable Distribution States," 58 *N.Y.U. L. Rev*. 554, 561 (1983); Bryan Mauldin, "Identifying, Valuing, and Dividing Professional Goodwill as Community Property at Dissolution of the Marital Community," 56 *Tul. L. Rev*. 313-314 (1981).

[38]*See, e.g.*, Ibrahim, *supra* note 37, at 8 (2005) ("The most prevalent type of goodwill is business, or 'enterprise,' goodwill. Its prevalence (and the relative obscurity of personal goodwill) is revealed by the tendency of legal writers to refer to business goodwill as simply 'goodwill'") (citations omitted).

[39]*See* Kelly, *supra* note 36, at 579.

[40]*See* Allen M. Parkman, "A Systematic Approach to Valuing the Goodwill of Professional Practices," in Ronald L. Brown, *Valuing Professional Practices & Licenses*, at 8-9 (3d ed. 1996).

[41]209 F.3d 998 (7th Cir. 2000).

[42]*Id.* at 999-1,000.

[43]FASB, Accounting Standards Codification (ASC), Master Glossary, "Goodwill"; *see further* FASB, Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" (2001).

"other assets" under the FASB definition.[44] The value is not identified until there is a business combination.[45]

Customer Goodwill

Regardless of tax and accounting concepts, goodwill represents value from a customer base. The Tax Court has noted that goodwill "is nothing more than the probability that the old customers will resort to the old place."[46] More broadly, goodwill includes the reputation and other qualities that attract new and old customers.

Narrow Customer Goodwill

Customer goodwill represents the quality of carrying on a specific business and retaining its historical customers. In a sale, the buyer can prevent the seller from continuing the same *business* but (without specific covenants) cannot prevent the seller's practice of a *trade*. The seller may even be able to solicit the same customers through a new business.

Of course, the buyer will normally obtain a noncompete agreement to restrain the seller's trade.[47] Many courts and commentators trace the origin of that practice to the English case of *Cruttwell v. Lye*.[48] The Lyes owned a business that went bankrupt and whose assets were sold in liquidation. The plaintiff acquired some of the business's facilities at auction and, when the Lyes began competing, sought to enjoin them.

Noting that goodwill was from expected patronage of operating the same business from the same location, the court said that the goodwill was not an implied, unwritten contract, restraining all trade in the same field.[49] As a result, the Lyes were free to solicit customers as long as they did not operate the same business from the same premises.

That result may seem counterintuitive. Of course, this formulation of customer goodwill is extremely narrow, excluding all other potential sources of value.[50] "Customers" means only direct patrons, excluding, for example, supplier goodwill or reputation in the community.[51] Similarly, it is limited to the "old place," the historical business location.[52]

In *Cruttwell*, a particular goodwill was sold: half a business and one of two premises, "together with the good-will of the long established trade."[53] That *Cruttwell* dealt with a sale of only part of a business is often ignored. Another 19th-century British decision dismissed this definition of goodwill taken from *Cruttwell* as "too narrow."[54]

Broad Customer Goodwill

Today the average businessperson understands customer goodwill to include all reputation and advantages among existing and potential customers. The seller of a business can endeavor to transfer the loyalty and business relationships of all the former customers to the buyer.[55] That goodwill can also include the business reputation associated with a trademark.[56]

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[44]*See* Parkman, *supra* note 40 ("The accounting concept of goodwill is directed not so much to the nature of goodwill as to its measurement. The general feeling is that verbal descriptions of goodwill are inadequate and that the only way to determine what is meant by goodwill is to observe the way that it is measured") (citations omitted); Kelly, *supra* note 36, at 578-579 ("Explaining the basis for goodwill has sometimes been confused with its measurement. This is understandable to some degree since the accounting concept of goodwill focuses on ascribing the value of goodwill as part of a sale of a business rather than on attempting to describe the nature of goodwill. Only through a sale is the existence of goodwill confirmed. From an accounting standpoint, goodwill is a payment in excess of the fair market value of identifiable net assets of a business. Under this view, it is a retrospective entry on a balance sheet after a sale") (citations omitted).

[45]FASB, ASC, Master Glossary, "Goodwill"; *see, e.g.*, *Dugan v. Dugan*, 457 A.2d 1, 5-6 (N.J. 1983) ("Accountants will usually not reflect goodwill on a balance sheet until after a business has been sold and then state goodwill in terms of the excess paid for the net assets over book value").

[46]*See Ballantine v. Commissioner*, 46 T.C. 272, 278 (1966) (citation omitted); *see further Spayd v. Turner, Granzow & Hollenkamp*, 482 N.E.2d 1232, 1236 (Ohio 1985) (calling this specific form of customer goodwill "a much narrower definition").

[47]*See, e.g.*, *Piggly Wiggly Corp. v. Saunders*, 1 F.2d 572 (W.D. Tenn. 1924); *Kentucky-Tennessee Light & Power Co. v. Paris*, 173 Tenn. 123 (1938); *Dillon v. Nicodeme*, 117 S.W.2d 868, 869 (Tex. App. 1938); *Rossing v. State Bank of Bode*, 181 Iowa 1013 (1917).

[48]17 Ves. 335 (U.K. Ct. Ch. 1810); *see, e.g.*, *Newark Morning Ledger Co. v. United States*, 507 U.S. 546, 572 (1993) (Souter, J., dissenting); *Menendez v. Holt*, 128 U.S. 514, 522 (1888); *In re Marriage of McTiernan & Dubrow*, 133 Cal. App. 4th 1090, 1098 n.6 (2006) (citation omitted); *Ballantine*, 46 T.C. at 278; *Horton v. Commissioner*, 13 T.C. 143, 148 (1949); *In re Lyons*, 27 Cal. App. 2d 293, 297-298 (1938); *Fine v. Lawless*, 139 Tenn. 160 (1917); *Bell v. Ellis*, 33 Cal. 620, 625 (1867) ("According to Lord Eldon it is the probability that the old customers will resort to the old place").

[49]*Cruttwell*, 17 Ves. at 336-337 ("The good-will, which has been the subject of sale, is nothing more than the probability that the old customers will resort to the old place").

[50]*Id.* (stating that goodwill was "nothing more" than the old customers' tendency to return).

[51]*Id.*

[52]*Id.*

[53]*Id.* at 336.

[54]*Churton v. Douglas*, Johns. 183, 188 (1859) (disregarding the view that *Cruttwell* "laid down the principle that assignment of the 'goodwill' of a trade, *simpliciter*, carries no more with it than the advantage of occupying the premises which were occupied by the former firm, and the chance you thereby have of the customers of the former firm being attracted to those premises") (emphasis in original).

[55]*See, e.g.*, *J.C. Cornillie Co. v. United States*, 298 F. Supp. 887, 897 (E.D. Mich. 1968).

[56]*See, e.g.*, *Burgess v. Gilman*, 475 F. Supp.2d 1051, 1057 (D. Nev. 2007).

Courts often cite Justice Joseph Story's definition of this broader goodwill:

> The advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement, which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances, or necessities, or even from ancient partialities, or prejudices.[57]

While England's *Cruttwell* decision emphasized repeat customers at the same location, Justice Story's American customer goodwill is vastly broader. Not only does it include value ''from constant or habitual customers,'' but it also includes value on account of celebrity, reputation, and even accidental circumstance.

Thereafter, Justice Benjamin Cardozo expanded broad customer goodwill even further.[58] He wrote that customer goodwill included ''any privilege that gives a reasonable expectancy of preference in the race of competition'' in relation to the ''succession in place or name or otherwise to a business that has won the favor of its customers.''[59] Rather than enumerating the ways in which customer goodwill can manifest itself, Cardozo included *any* possible advantage, excluding only what no rational person would pay for.[60]

Part 2 of this article will appear in the January 28, 2013 issue of *Tax Notes*.

[57]Joseph Story, *Commentaries on the Law of Partnership as a Branch of Commercial and Maritime Jurisprudence*, section 99, at 157 (7th ed. 1881) (cited in *Newark Morning Ledger*, 507 U.S. at 555); *Des Moines Gas Co. v. Des Moines*, 238 U.S. 153 (1915); *Metropolitan Bank v. St. Louis Dispatch Co.*, 149 U.S. 436, 446 (1893); *In re Marriage of McTiernan & Dubrow*, 133 Cal. App. 4th at 1098; *In re Marriage of Fenton*, 134 Cal. App. 3d 451 (1982); *Detter v. Miracle Hills Animal Hospital*, 269 Neb. 164 (2004); *McDiarmid v. McDiarmid*, 649 A.2d 810, 813 (D.C. App. 1994); *Gilmore Ford Inc. v. Turner*, 599 So.2d 29, 31 (Ala. 1992); *Prahinski v. Prahinski*, 540 A.2d 833, 839 (Md. Ct. Spec. App. 1988); *Taylor v. Taylor*, 222 Neb. 721, 727-728 (1986) (quoting *Haverly v. Elliott*, 39 Neb. 201 (1894)); *Dugan v. Dugan*, 92 N.J. 423 (1983); *Finn v. Finn*, 658 S.W.2d 735, 742, n.3 (Tex. App. 1983); *Holbrook v. Holbrook*, 309 N.W.2d 343, 352 (Wis. Ct. App. 1981); *Levy v. Levy*, 164 N.J. Super. 542 (1978); *Masquelette v. Commissioner*, 239 F.2d 322, 325 (5th Cir. 1956); *In re Lyons*, 27 Cal. App. 2d at 297-298; *Bell v. Ellis*, 33 Cal. 620 (1867)).

[58]*See In re Brown*, 242 N.Y. 1, 6 (1926) (''Men will pay for any privilege that gives a reasonable expectancy of preference in the race of competition. . . . Such expectancy may come from succession in place or name or otherwise to a business that has won the favor of its customers. It is then known as good will. Many are the degrees of value. At one extreme there are expectancies so strong that the advantage derived from economic opportunity may be said to be a certainty. At the other are expectancies so weak that for any rational mind they may be said to be illusory. We must know the facts in any case'') (citation omitted).

[59]*Id.*

[60]*Id.*