

USE OF CPAS IN A DOMESTIC RELATIONS MATTER

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GOODWILL - DEFINITION; METHODS OF VALUATION OF
GOODWILL; THE FAIR MARKET VALUE
THEORY; FACTORS TO BE CONSIDERED
IN DETERMINING GOODWILL; UNEQUAL
SALARIES CLAIMED AS THE SALE OF
GOODWILL; EFFECT OF A CONTRACTED
VALUE OF A PROFESSIONAL'S INTEREST
IN THE PRACTICE; IS THE VALUED
ABILITY PERSONAL IN NATURE.

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GOODWILL

DEFINITION

Goodwill has been defined as, "Every possible advantage that has been acquired by a proprietor in carrying on his business, whether connected with the premises or the name under which it is managed."

Goodwill has often been called "Blue Sky"; one must look up to the heavens to ascertain it's existence or value.

According to the Generally Accepted Accounting Principles, goodwill can only appear on a financial statement when it has been purchased as part of the business or profession and, therefore, does not exist unless it is purchased.

Arizona has stated in Wisner v. Wisner, Ariz. App. 631 P2d 115 (1981) that there can be goodwill in the professional corporation. The court stated, "Goodwill value is a term which is elusive of any precise definition". The court went on to state, "In Arizona, goodwill has been defined as that asset, intangible in form, which is an element responsible for profits in a business."

METHODS OF VALUATION OF GOODWILL

In Wisner v. Wisner, the court recognized the difficulty in placing a value on goodwill and stated, "No rigid and unvarying rule for the determination of the value of goodwill has been laid down by prior case law and each case must be determined on its own facts and circumstances."

Other states have valued goodwill using the following methods:

Purchase Method - excess of the acquisition cost over the fair market value of the assets acquired.

Multiple Of Annual Billings Method - annual gross income times "X".

The Capitalization of Earnings in excess of a fair rate of return on net tangible assets is used to determine the fair market value of the intangible assets of a business.

THE FAIR MARKET VALUE THEORY

The price at which the business or profession being valued is likely to sell for on the open market. This should be based upon the sale of similar businesses or professional practices.

The criteria is the following:

Is It Saleable? Is the business or profession saleable for more than the market value of the assets, less the liabilities? Can anyone else capitalize on the "advantage built up" other than the present owner? Is the goodwill saleable?

Is It Profitable? The average person purchasing a business is paying for goodwill because he intends to earn substantially more as an employer than he could as an employee. In effect, he is BUYING HIMSELF A HIGH PAYING JOB. Therefore, a business losing money over an extended period of time probably has no goodwill.

Is It Desirable? A general practitioner has his practice in an inner-city neighborhood. Although many elements of goodwill are present, the practice may be unsaleable because no one is willing to practice in the undesirable location.

Is It Transferrable? Can a sole practitioner attorney known as "the person" in defending criminal tax fraud, sell the goodwill of his practice? It is highly unlikely.

FACTORS TO BE CONSIDERED IN DETERMINING GOODWILL

1. Have actual sales in similar businesses or professions occurred? There have actually been many sales of accounting practices in the Phoenix area. The sales price has been between one and two times the annual billings. This is dependent upon the nature of the practice and the terms given upon sale.
2. The existence of written contracts for the services to be rendered by the professional. (e.g. Radiologists having contracts with hospitals.)
3. The percentage of billings generated by ancillary personnel. (e.g. Nurses, physical therapists, technicians and legal assistants.)
4. The name identification connected with the professional.
5. The percentage of the fees generated as a result of the use of the equipment and facilities.

UNEQUAL SALARIES CLAIMED AS THE SALE OF GOODWILL

Counsel for the non-professional often claim that sales of medical practices occur for an amount in excess of the assets less liabilities by virtue of the newer doctor taking less of a salary for an agreed to period of time. This is not a sale of goodwill if,

in fact, the more established doctor has greater experience and commands a greater salary, and/or the more established doctor generates a larger dollar volume of patients than the newer doctor.

EFFECT OF A CONTRACTED VALUE OF A PROFESSIONAL'S INTEREST IN THE PRACTICE (Buy-Sell Agreement)

If there has been a bona fide Buy-Sell Agreement in existence for a substantial period of time prior to the filing of the dissolution, it should be honored as the value of the professional's interest in the practice. To determine if it is bona fide, we must consider whether the certificate of value has been brought current at least once per year. We must further determine if the stated value bears a close relationship to the fair market value of the assets less liabilities. The contract should not be a sham brought into being for the purpose of the dissolution.

IS THE VALUED ABILITY PERSONAL IN NATURE - Not Separate And Apart From Personal or Individual Ability

A professional practice may not be readily saleable in the open market even though it may have a tremendous value to the practitioner. Like an heirloom, the value is INTRINSIC and not equatable with dollar amounts.

Hypothetically, a sole practitioner attorney is earning \$200,000.00 a year in his practice. By using the capitalization of earnings theory, his earnings are substantially more than the average attorney in Phoenix. On that theory, his practice has a substantial goodwill. In fact, this goodwill could not be recognized upon the termination of his practice.

This attorney liquidates the assets of his practice and based on a fair market value, receives no goodwill. He then accepts a position as vice president and general counsel for XYZ Corporation earning a salary of \$200,000.00 per year. Since this is still substantially higher than the earnings of the average attorney in the Phoenix area, shouldn't there be goodwill attached to his employment? The answer, of course, is no. The underlying question is what is the difference between the two hypotheticals?

In Nail v. Nail, (Tex. 1972) 486 SW2d 761 - The Court said accrued goodwill of an ophthalmologist based upon his personal skill, experience and reputation did not constitute property that was subject to division as part of his estate. "That it did not possess value or constitute an asset separate and apart from his person, or from his individual ability to practice his profession and that it would be extinguished in the event of his death, retirement or disability, as well as in the event of the sale of his practice or the loss of his patients, whatever the cause."