

Personal Goodwill and Corporate Goodwill within the Family Law Context

Frank “Chip” Brown, CPA

The valuation of “personal” goodwill and “corporate” goodwill is often a disputed issue in a marital dissolution matter. Depending on the prevailing state statute, the distinction between these two types of goodwill may play an important role in determining which assets are marital property and which assets are separate property. Valuation analysts can provide significant guidance and support to family law counsel with regard to identifying and quantifying professional goodwill and business goodwill within a family law context. Similarly, family law counsel can provide invaluable legal guidance to the analyst regarding the relevant statutory authority and judicial precedent within the subject family law jurisdiction.

INTRODUCTION¹

Valuation analysts (“analysts”) are often called on to value goodwill as part of a family law controversy. Goodwill is defined as an intangible asset arising as the result of name, reputation, customer loyalty, location, products, and similar factors not separately identified. In many states, goodwill (or a portion thereof) has long been recognized as “property” in family law cases. Therefore, goodwill typically is subject to equitable distribution.

However, many courts have failed to draw a clear distinction between the two possible components of goodwill—namely, “professional goodwill” (often referred to as “personal” or “individual” goodwill) and “business goodwill” (often referred to as “corporate,” “institutional,” or “enterprise” goodwill). Hereafter, this discussion will refer, generally, to goodwill attributable to a person as personal goodwill and goodwill attributable to a company as enterprise goodwill. Depending on the statutory authority and judicial precedent in the subject state, this distinction may be important to the equitable distribution of marital estate property.

The distinction between personal goodwill and enterprise goodwill may be important to the segregation and quantification of separate and marital

property. This is particularly the case if the personal goodwill of the spouse was acquired or accumulated prior to the marriage.

In many jurisdictions, the question of when property is acquired by the spouse may be important in a marital dissolution. This is because property obtained prior to the marriage (separate property) is usually returned to its owner, while the marital estate property typically is divided between the spouses.

This discussion includes the following:

1. An overview of the nature and quantification of enterprise and personal goodwill as it applies to marital dissolution cases
2. A summary of the different procedures implemented by various state courts to determine the enterprise or personal components of goodwill

DISTINCTION BETWEEN PERSONAL AND ENTERPRISE GOODWILL^{2,3}

Within a family law context, goodwill historically has proven to be difficult to precisely define. The challenge relates to the fact that goodwill typically is generated by so many different factors and

combinations of factors that it is nearly impossible to list them all.

Exhibit 1 lists some of the characteristics, or indicators, regarding the existence of goodwill in a business or professional practice that the analyst may consider when identifying and quantifying the amount of personal goodwill and enterprise goodwill.

Personal goodwill, which is also called individual or celebrity goodwill, relates to an individual person. Typically, personal goodwill is not an asset that is owned by the business enterprise that employs the individual person.

Enterprise goodwill, which is also called company or institutional goodwill, is associated with the subject business enterprise. Typically, it is owned by the subject business enterprise (whether a corporation, personal services company, or professional practice).

It is often important to separately identify and individually value these two categories of goodwill. Such an approach is often required because there may be different legal, economic, and taxation consequences for each category or type of goodwill.

Some of the variables that affect whether personal goodwill exists include the following:

1. The type of service or product offered by the subject business enterprise
2. The subject individual's personal relationships with the customers or clients
3. The subject individual's direct impact on the operating focus, management, and key decisions of the subject business enterprise

Typically, more goodwill is allocated to the personal category if:

1. the individual makes essentially all significant management decisions regarding the subject business enterprise,

Exhibit 1 Goodwill Indicators

Personal Goodwill Indicators	Enterprise Goodwill Indicators
Small entrepreneurial business highly dependent on employee-owner's personal skills and relationships	Larger business, which has formalized its organizational structures and institutionalized its systems and control
No pre-existing covenant not to compete and/or employment agreement between selling company and employee-owner	Owner-employee has pre-existing covenant not to compete and/or employment agreement with the selling company
Personal service is an important selling feature in the company's product or services	The business is not heavily dependent on personal services
No significant capital investment in either tangible or identifiable intangible assets	The business has significant capital investments in either tangible or intangible assets
Only employee-owners own the company	The company has more than one owner, some of whom are not employees
Sales largely depend on the employee-owner's personal relationships with customers	Company sales result from name recognition, sales force, sales contracts, and other company-owned intangibles
Product and/or services know-how, and supplier relationships, rest primarily with the employee-owner	Company has supplier contracts and formalized production methods, patents, copyrights, business systems, etc.

“As a business enterprise increases in size and complexity, goodwill typically shifts from the personal goodwill category to the enterprise goodwill category.”

2. the operations of the subject business enterprise are not functionally or economically separate from the individual, and
3. the success of the subject business enterprise ultimately is directly interrelated with the activities of the individual.

In the early stages of a business enterprise’s operations, most internally created goodwill is personal goodwill. As a business enterprise increases in size and complexity, goodwill typically shifts from the personal goodwill category to the enterprise goodwill category.

GOODWILL THROUGH THE EYES OF THE COURTS⁴

While many family law courts acknowledge that both personal goodwill and enterprise goodwill exist in a professional practice, other courts recognize only enterprise goodwill. Still other courts have declined to recognize either professional goodwill or enterprise goodwill as a marital asset.

According to *BVR’s Guide to Personal v. Enterprise Goodwill*,⁵ the state family law court decisions to date fall into the following four general categories:

1. Category A – The court considers both personal and enterprise goodwill to be marital property—approximately one-third of the family law courts
2. Category B – The court considers enterprise goodwill to be marital property while personal goodwill is separate property—approximately one-half of the family law courts
3. Category C – The court considers neither personal nor enterprise goodwill as marital property—less than 10 percent of the family law courts
4. Category D – No decision or no clear decision—less than 10 percent of the family law courts

Category A—Person Goodwill and Enterprise Goodwill Are Marital Property⁶

There are 13 states that currently fall into Category A—that is, states that recognize both enterprise goodwill and personal goodwill as marital property subject to distribution in a divorce. The Category A states are Arizona, California, Colorado, Kentucky, Michigan, Montana, Nevada, New Jersey, New York, North Carolina, New Mexico, North Dakota, and Washington are included in this group of states.⁷

In 1974, in the case of *Golden v. Golden*, a California court held that the husband’s professional (i.e., personal) goodwill in his professional practice as a sole medical practitioner should be considered in the marital property subject to division. The husband argued that, since his goodwill was dependent on his personal reputation and his personal skill, it should not be considered a marital asset.

The California court ruled against the husband. The court concluded that in a matrimonial matter, “the practice of the sole practitioner husband will continue, with the same intangible value as it had during the marriage. Under the principles of community property law, the wife, by virtue of her position of wife, made to that value the same contribution as does a wife to any of the husband’s earnings and accumulations during marriage. She is as much entitled to be recompensed for that contribution as if it were represented by the increased value of stock in a family business.”⁸

In 1974, the focus of goodwill began to shift from the business enterprise to the individual employee/practitioner.

An analyst witness in *Foster v. Foster*⁹ was asked to estimate the fair value of goodwill of a medical practitioner, and not of his medical practice business. Family law courts in both Washington and New Mexico furthered this change in the perception of goodwill by including reputation as a key identifier in valuing professional practice goodwill.

As in the *In re Marriage of Lopez* decision,¹⁰ in the 1976 decision *In re the Marriage of Lukens*,¹¹ the Washington trial court held that factors contributing to the professional goodwill of an osteopathic practice included the practitioner’s age; health; past earning power; reputation in the community for judgment, skill, and knowledge; and his comparative professional success.¹²

Similarly, a Colorado appellate court ruled that a professional, like other entrepreneurs, could expect returning customers based on his established reputation for skill and expertise. That court held that these expectations were part of goodwill.

And, that Colorado court concluded that this goodwill “can be as unfair and inequitable as those states that exclude both personal and enterprise goodwill. For instance, this group disregards the legitimate double-dipping concerns of counting the goodwill—especially the goodwill attaching personally to the professional—both as a marital asset subject to division and as a source of future earnings to pay alimony and support.”

The family law court cases in this category shifted emphasis to the individual professional in the business and away from the actual business goodwill. The *Lopez* decision was instrumental in identifying the factors that were relevant in determining the individual professional’s goodwill.

The factors listed in the *Lopez* decision related to consideration of the individual professional’s:

1. demonstrated earnings power;
2. reputation in the community for judgment, skill, and knowledge;
3. comparative professional success; and
4. nature and duration of the professional’s practice.

Category B—Personal Goodwill Is Not Marital Property¹³

On the other hand, 25 states/jurisdictions fall into Category B. This category includes only the enterprise component of goodwill in the calculation of marital assets. In these jurisdictions, the professional or personal goodwill of a spouse is considered separate property. The Category B states include Alaska, Arkansas, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Illinois, Indiana, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, New Hampshire, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, Utah, Virginia, West Virginia, Wisconsin, and Wyoming.¹⁴

For example, in *Nail v. Nail*, a Texas court held that the accrued goodwill of a medical practice based on the personal skill, experience, and reputation of the individual physician, as well as on the expectation that the individual physician would continue to practice, did not constitute property that was subject to division.¹⁵

Also, in the 1981 case of *Nehorayoff v. Nehorayoff*, a New York court considered the issue of goodwill associated with a professional corporation that performed abortions. In finding a lack of

professional goodwill, the New York court reasoned that the patients in the abortion practice did not develop a personal relationship with the physician. As a result, there was no expectation that a change in physicians would lead to a significant decline in business as it may in a private practice.¹⁶

Likewise, the Indiana Supreme Court stated that if goodwill is “attributable to the individual, it is not a divisible asset and is properly considered only as future earning capacity that may affect the relative property division.”¹⁷

In *Hanson v. Hanson*, the Missouri Supreme Court concluded “[g]oodwill has no separate existence; it has value only as an incident of a continuing business. . . . We define goodwill within a professional setting to mean the value of the practice which exceeds its tangible assets and which is the result of the tendency of clients/patients to return to and recommend the practice irrespective of the reputation of the individual practitioner.”¹⁸

In some family law judicial precedent, the courts take the position that if goodwill is to be recognized and divisible at all, then it should be completely separate and distinct from the professional’s reputation.

In *Thompson v. Thompson*, the Florida Supreme Court held that “clients come to an individual professional to receive services from that specific person. Even so, if a party can produce evidence demonstrating goodwill as an asset separate and distinct from the other party’s reputation, it should be considered in distributing marital property.”¹⁹

Category C—Personal Goodwill and Enterprise Goodwill Are Not Marital Property

Category C states—including Kansas, Louisiana, Mississippi, South Carolina, and Tennessee—



consider neither personal goodwill nor enterprise goodwill as marital property subject to distribution.²⁰

In *Singley v. Singley*, the Mississippi Supreme Court held that it was “join[ing] the jurisdictions that adhere to the principle that goodwill should not be used in determining the fair market value of a business, subject to equitable division in divorce cases.”²¹

The Mississippi court stated that it is “increasingly difficult for experts to place a value on goodwill because it is such a nebulous term subject to change on a moment’s notice.”²²

Furthermore, the Mississippi court noted that “It is also difficult to attribute the goodwill of the individual personally to the business. The difficulty is resolved, however, when we recognize that goodwill is simply not property; thus it cannot be deemed a divisible marital asset in a divorce action.”²³

Category D—No Clear Decision as to Whether Personal Goodwill or Enterprise Goodwill Are Marital Property

Category D states—including courts in Alabama, Georgia, Idaho, Iowa, Maine, Ohio, South Dakota, and Vermont—either (1) have yet to clarify their judicial position on the subject of goodwill or (2) have conflicting judicial decisions on the books.²⁴

CONCLUSION

While there seems to be a consensus that personal goodwill may exist in a professional practice, there is no consensus regarding how to treat personal goodwill when distributing the property includable in a marital estate.

Family law counsel can benefit from valuation guidance provided by a qualified analyst with regard to identifying and quantifying personal goodwill and enterprise goodwill within a family law context.

In order to provide the highest level of service and relevant conclusions, analysts should seek legal guidance from family law counsel regarding the relevant statutory authority and judicial precedent that addresses the inclusion of goodwill as marital property within the subject family law jurisdiction.

Notes:

1. Alexis A. Dawicki and Richa Prakash, “Personal Goodwill and Business Goodwill—Are They Marital Assets?” Willamette Management Associates *Insights* (Special Issue 2008).

2. Ibid.
3. Robert F. Reilly, “Valuation of Goodwill within the Family Law Context,” Willamette Management Associates *Insights* (Special Issue 2008).
4. Dawicki and Prakash, “Personal Goodwill and Business Goodwill—Are They Marital Assets?”
5. Adam Manson, ed., *BVR’s Guide to Personal v. Enterprise Goodwill*, 5th ed. (Portland, OR: Business Valuation Resources, 2012).
6. Dawicki and Prakash, “Personal Goodwill and Business Goodwill—Are They Marital Assets?”
7. Christopher A. Tiso, “Present Positions on Professional Goodwill,” *BVR’s Guide to Personal v. Enterprise Goodwill*, 5th ed..
8. *Golden v. Golden*, 75 Cal. Rptr. 737-738 (Cal. App. 1969).
9. *Foster v. Foster*, 42 Cal. App. 3d 578 (Cal. App. 1974).
10. *In re Marriage of Lopez*, 558 P.2d 279, 281 (Wash. App. 1976).
11. *In re Marriage of Lukens*, 16 Wash. App. 481, 558 P.2d 279 (1976).
12. Mary Kay Kisthardt, “Professional Goodwill in Marital Dissolution Cases,” in Ronald L. Brown, ed., *Valuing Professional Practices and Licenses: A Guide for the Matrimonial Practitioner*, 4th ed. (Englewood Cliffs, NJ: Prentice Hall, 1998).
13. Allen M. Parkman, “A Systematic Approach,” in Ronald L. Brown (ed.) *Valuing Professional Practices & Licenses: A Guide for the Matrimonial Practitioner*, 3rd ed. (New York: Wolters Kluwer, 2015).
14. Tiso, “Present Positions on Professional Goodwill.”
15. *Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972).
16. *Nehorayoff v. Nehorayoff*, 437 N.Y.S.2d 584 at 591 (N.Y. Sup. Ct., 1981).
17. *Yoon v. Yoon*, 711 N.E.2d. 1265, 1269 (Ind. 1999).
18. *Hanson v. Hanson*, 738 S.W.2d 429 (Mo. 1987).
19. *Thompson v. Thompson*, 576 So.2d 637 (Fla. Dist. Ct. App. 2005).
20. Tiso, “Present Positions on Professional Goodwill.”
21. *Singley v. Singley*, 846 So.2d 1004 (Miss. 2002).
22. Ibid.
23. Ibid.
24. Tiso, “Present Positions on Professional Goodwill.”

Frank “Chip” Brown is a managing director in our Atlanta practice office. Chip can be reached at (404) 475-2306 or at cbrown@willamette.com.

