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Personal Goodwill and Valuation Issues in Marital Dissolution Cases

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Karolina Calhoun, Senior Vice President at Mercer Capital, has been involved with hundreds of valuation and litigation support engagements in a diverse range of industries on local, national and international levels. Prior to joining Mercer Capital, Karolina was a Senior Auditor at EY (Ernst & Young) in their Audit and Assurance Services practice.

As a member of Mercer Capital's Litigation Group, she provides valuation and forensics services for family law, gift & estate planning, commercial litigation, transactions (M&A), and further matters related to privately held businesses, dissenting shareholders, intellectual property, personal goodwill, etc. With her forensics accreditation, she provides economic and financial damages studies, asset tracing, lost profits, and lifestyle analyses. Karolina has testified over 25 times.

Karolina served as the 2020 and the 2021 Valuation Chair of the AICPA's Forensic and Valuation Services Conference and is a member of the AICPA's CFF Exam Writing Task Force. Karolina is a member of the American Academy of Matrimonial Lawyers (AAML) Foundation, Forensic and Business Valuation Division. In addition, she has served on the AICPA Business Valuations Committee since 2022.



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Session Overview

1. What is goodwill?
2. What is personal vs. enterprise goodwill?
3. Why is personal vs. enterprise goodwill important in valuations for divorce?
4. Methods and considerations for determination allocation to each
5. Case precedent – differs by state
6. Examples

Reminder & Disclosure!

Facts and circumstances differ tremendously from matter to matter.

In real life, refer to attributes unique and specific to the ownership and subject interest at hand, which may vary from entity to entity.

The following slides and examples are for illustrative purposes only and do not present any absolute opinions or treatments regarding the illustrative fact patterns depicted.

What Is Goodwill? – A Business Valuation Definition



Per the International Valuation Glossary – Business Valuation, Goodwill is defined as:

- An intangible asset which represents any future economic benefit arising from a business or a group of assets which is not individually identified or separately recognized. **Goodwill can arise as a result of name, reputation, customer loyalty, location, products and similar factors not separately identified.**
- In the context of a business combination, goodwill is measured as the difference between (A) the aggregate of (i) the value of the consideration transferred (generally at Fair Value), (ii) the amount of any noncontrolling interest, and (iii) in a business combination achieved in stages, the acquisition-date Fair Value of the acquirer’s previously held equity interest in the acquiree, and (B) the net of the acquisition-date amounts of the Identifiable Assets acquired and the liabilities as assumed.

In plain language:

Value = Value of Tangible Assets + Value of Intangible Assets

Some of the intangible assets can be identified and valued, such as workforce. Others fall into the catch-all goodwill category.

What Is Goodwill? – BVR Guide Definition

Per BVR's *Guide to Personal v. Enterprise Goodwill*:

- “The total value of a Company less those other assets, such as current assets, investments and fixed assets, **whose value can be separated through other means.**”
- That intangible asset arising as a result of name, reputation, customer loyalty, locations, products and similar factors not separately identified.”

Enterprise Goodwill vs. Personal Goodwill

Enterprise goodwill generally is interpreted as representing value that is owned and/ or that has been created by an enterprise and that can be transferred. Identifiable intangible assets typically classified within the enterprise goodwill category include the following:

1. Trademarks and trade names
2. Patented and unpatented technology
3. Copyrights
4. Customer lists and relationships (patient files/records)
5. Contracts (employment, noncompete agreements)
6. Phone number
7. Leasehold
8. Trained and assembled workforce
9. Location

Personal goodwill generally is interpreted as representing attributes, that are unique to, and inseparable from, an individual. Attributes typically classified within the personal goodwill category include the following:

1. Personality
2. Reputation
3. Personal skill, expertise and knowledge
4. Personal relationships

In essence, personal goodwill is represented by certain attributes that are deemed to be incorporated into the very being of an individual, and, therefore, are **unable to be sold or transferred to another individual.**

Why Does Personal vs. Enterprise Goodwill Matter in Divorce?

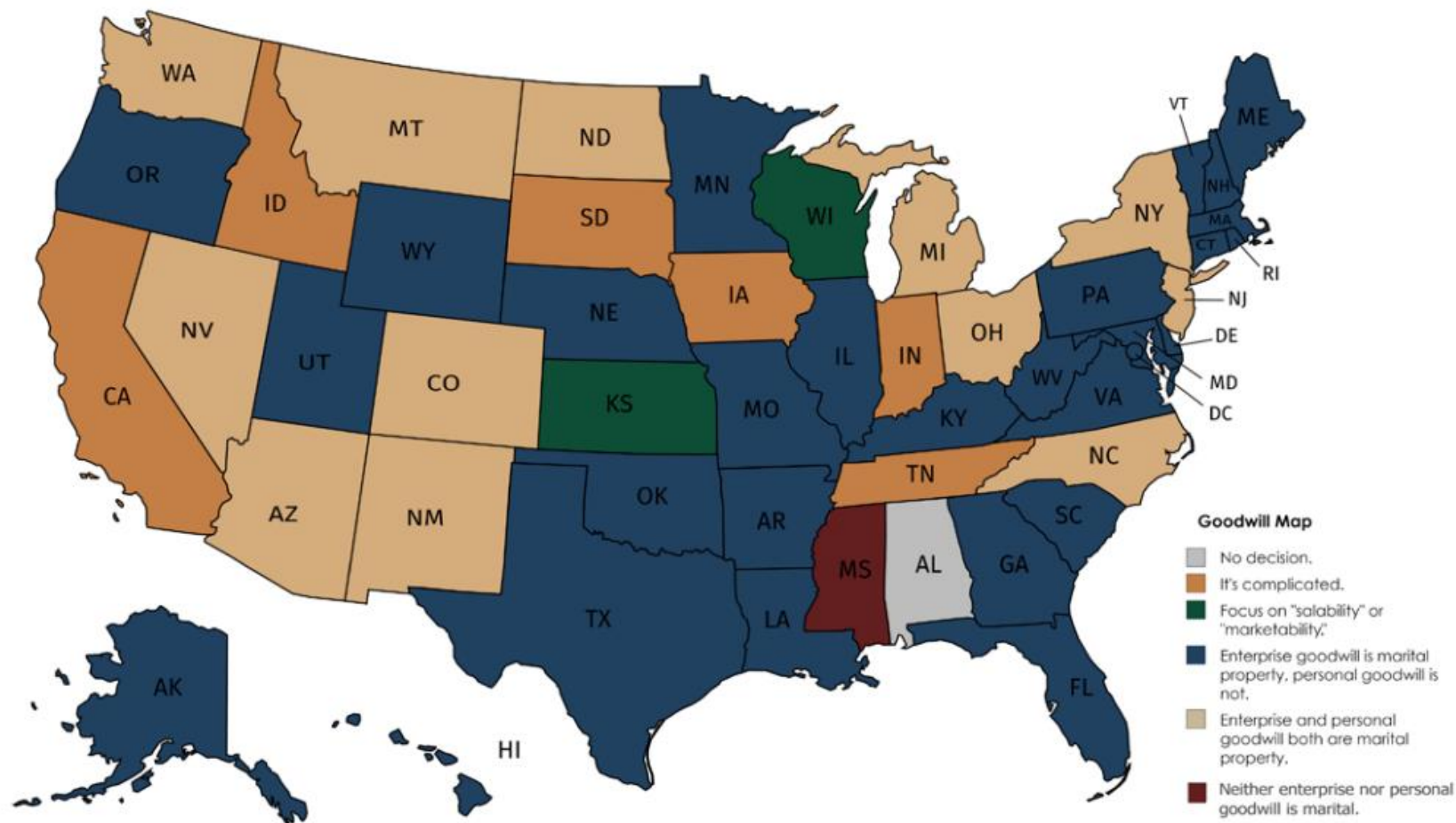
In a transaction setting, the seller of a business would prefer to allocate as much of the purchase price to personal goodwill as possible for tax benefits as it would be taxed at long-term capital gains rates rather than ordinary income

In a divorce setting, the value allocated to personal goodwill may not be a divisible marital asset (depending on state):

- **Personal = separate & not divisible**
- **Enterprise = marital & divisible**

Thought to ponder: motive in transaction is likely tax reduction. Is this the same in a divorce setting? How could it be different, and, how does one reconcile these?

Why Is Personal vs. Enterprise Goodwill Important?



Business Valuation Resources | bvresources.com | 1-503-479-8200

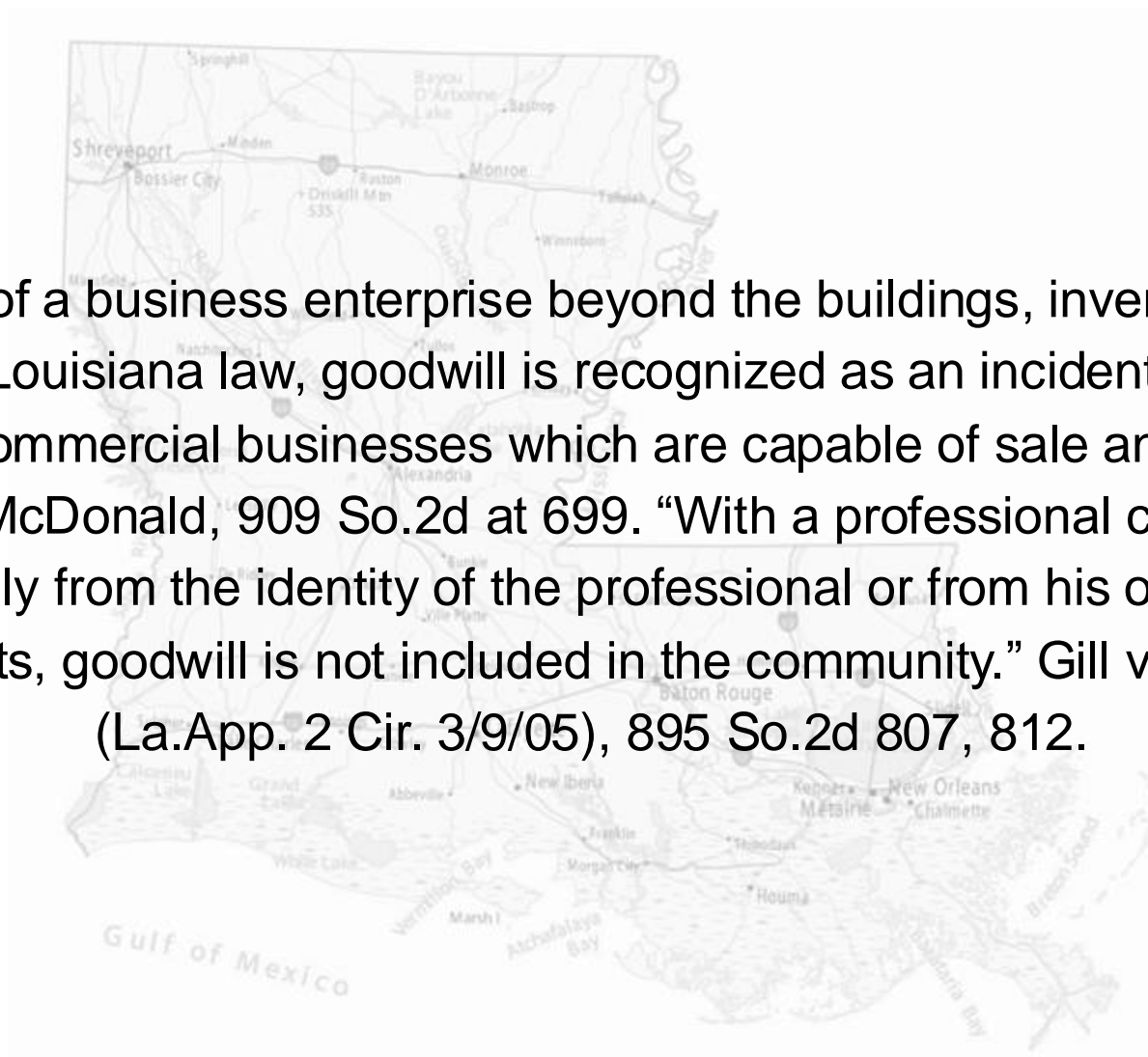




Louisiana

Louisiana Revised Statutes 9:2801.2 provides that:

In a proceeding to partition the community, the court may include, in the valuation of any community-owned corporate, commercial, or professional business, the goodwill of the business. However, that portion of the goodwill attributable to any personal quality of the spouse awarded the business shall not be included in the valuation of a business.



“The excess value of a business enterprise beyond the buildings, inventory and contracts is goodwill. Under Louisiana law, goodwill is recognized as an incidental property right in connection with commercial businesses which are capable of sale and transfer from one owner to another.” McDonald, 909 So.2d at 699. “With a professional corporation, where the goodwill results solely from the identity of the professional or from his or her relationship with clients or patients, goodwill is not included in the community.” Gill v. Gill, 39,406, p. 7 (La.App. 2 Cir. 3/9/05), 895 So.2d 807, 812.

Personal vs. Enterprise Goodwill

Enterprise Goodwill: derived from characteristics specific to the business, regardless of who operates it.

- Louisiana Orthopedic Alliance (LOA): **Largest** orthopedic surgery **group** with **20 locations** and **68 MDs and 27 NP/Pas**



Personal Goodwill: derived from characteristics specific to the individual.

- Tom's Valuation Company, LLC: **Sole service provider** with no other employees/providers, **key relationship driver**, no proprietary technology, few recurring projects, no customer contracts that could be completed by a substitute provider for the company



Factors to Consider When Determining Personal Goodwill

Inseparable from the individual in nature

Nontransferable in nature

Tend to arise in professional service industries;
particularly, sole practitioners

.....

How **unique** are the services being provided?

Can the **rights** to an individual's goodwill be transferred?

What about non-compete agreement and/or employment agreement?

Does personal goodwill apply to owners of the business only?



Factors to Consider When Determining Enterprise Goodwill

Separable from the individual in nature

Transferable in nature

Standardized operations, policies, procedures, onboarding, recruiting

Location

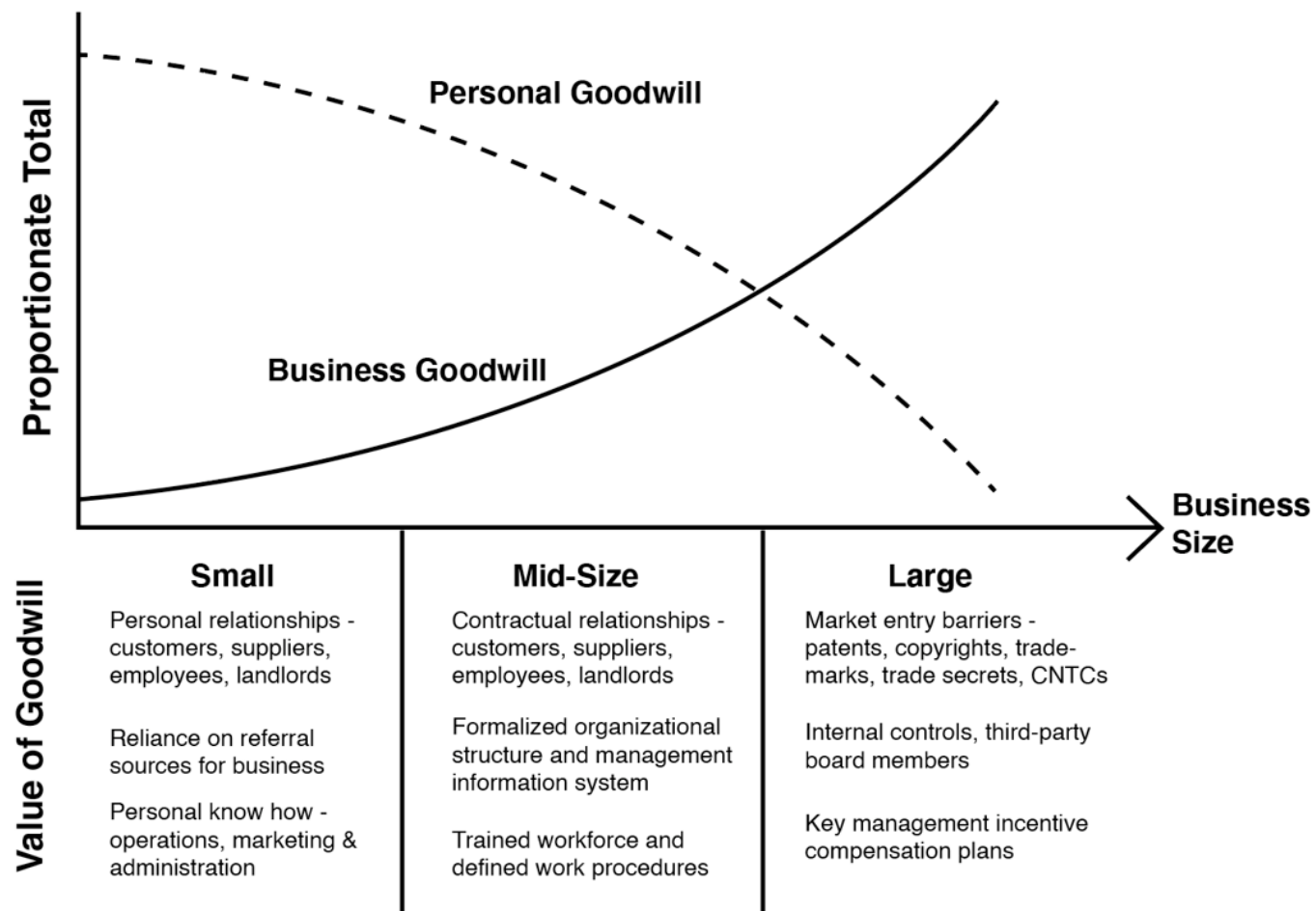
Products and services offered

Size and efforts of workforce and non-divorcing spouse(s)

Revenue cycle and revenue contributors



The Goodwill Transition: Personal to Business



Source: *BVR's Guide to Personal v. Enterprise Goodwill*

Personal vs. Enterprise – Side-by-Side Examples

<u>Category</u>	<u>Example Evidence of Personal Goodwill</u>	<u>Example Evidence of Enterprise Goodwill</u>
Advertising	Focus on the reputation, experience and skills of the owner/operator; business name is the name of the owner	Focus on the entity without mentioning management or ownership; business name different from owner’s name; corporate logo
Repeat Customers	Customers return due to personal relationship with owner	Customers return due to location, convenience or other company specific factors.
Referrals	Other professionals refer business based upon skills and reputation of service provider; no formal referral contracts	Other professionals refer business based on organizational affiliation; referral relationships are contractually defined and often transferrable
Management Depth	The business is either completely or mostly reliant on one owner for income generation; income associated with ownership interest being valued would disappear if that owner left	The business generates income from multiple producers; income associated with the ownership interest being valued would not disappear if that owner left

Source: *BVR’s Guide to Personal v. Enterprise Goodwill*

Methodologies for Calculating Personal Goodwill

Methodologies for Calculating Personal Goodwill

1. Income approach (Loss-of-income method or “with-without analysis”)
 - Quantify the cash flows of the business with and without this person
 - If a service business assuming similar margins by provider, revenue contribution can be an effective proxy for earnings attributable sole to spouse in question
2. Market approach
 - Observe difference in valuation multiples for transactions with and without employment agreements
3. Qualitative approach (Multi-attribute utility model or “MUM”)
 - Subject approach ascribing the importance of various goodwill factors and determining if they are enterprise or personal goodwill
 - Modified MUM

Methodologies for Calculating Personal Goodwill (Continued)

“Top-Down”

Value entire entity

> Separately identify & eliminate personal goodwill

“Bottom-Up”

Value net tangible assets

Value entire entity

> Identify transferable intangible value & eliminate

Considerations & Potential Issues w/ Methodologies

Facts and circumstances differ significantly from matter to matter

No one-size-fits-all approach, or even standardized methods

Certain methods are plagued with subjective inputs & assumptions

Carefully consider potential bias and interview objectivity

Compensation versus Business Value

Beware of Double Count, Triple Count, etc.

- **What does this mean? Let's discuss.**

“MUM” – Multiattribute Utility Model

Qualitative model for distinguishing enterprise goodwill from personal goodwill

Developed by David Wood, CPA/ABV, CVA in 2003

MUM is the organization of attributes and your arguments

Upheld in *In Re Marriage of Alexander*, Appellate court of Illinois (5th District No. 5-05-019, September 2006)

Many layers of inputs/assumptions

MUM Example

Permission to Present from David Wood

Multi-Attribute Utility Model									
Professional Goodwill Attributes (PGA)					Enterprise Goodwill Attributes (EGA)				
	Importance Utility	Existence Utility	Mult. Utility	Percent		Importance Utility	Existence Utility	Mult. Utility	Percent
Ability, Skill and Judgement	5	4	20	10.64%	Business Location	5	4	20	10.64%
Personal Reputation	3	3	9	4.79%	Business Reputation	5	4	20	10.64%
Work Habits	3	3	9	4.79%	Repeating Revenue Stream	5	4	20	10.64%
Closeness of Contact	3	2	6	3.19%	Systems and Organization	5	4	20	10.64%
In-bound Personal Referrals	3	2	6	3.19%	Multiple Service Providers	5	3	15	7.98%
Staff, Personal	3	2	6	3.19%	Business Name	3	3	9	4.79%
Age and Health	1	4	4	2.13%	Inbound Referrals	3	3	9	4.79%
Important Personal Nature	1	2	2	1.06%	Staff, Enterprise	3	3	9	4.79%
Marketing and Branding	1	1	1	0.53%	Marketing and Branding	3	1	3	1.60%
Personalized Name	1	-	-	0.00%	Multiple Locations	1	-	-	0.00%
Total Multiplicative Utility (PGA)			63	33.51%	Total Multiplicative Utility (EGA)			125	66.49%
Personal Goodwill Allocation (Rounded)				35%	Enterprise Goodwill Allocation (Rounded)				65%
Total Multiplicative Utility (PGA+EGA)			188	100.00%					

(1) Importance Utility is ranked in three categories - key (5), more important (3), important (1).
 (2) Existence Utility is weighted from 0-4. 0 indicates no presence, 4 indicates strong presence.

The “Simplified/Modified MUM”

Goodwill Attributes			
Enterprise Attributes	Add to Scale (0,1)	Personal Attributes	Add to Scale (0,1)
Assemblage of assets	1	Ability, skills, judgment	1
Barriers to entry	0	Age and health of owner	0
Business location	0	Closeness of contact	1
Business locations (multiple)	0	Comparative professional success	1
Business name	0	Marketing and branding	0
Business reputation	0	Personal referrals and referral diversity	1
Client base	0	Personal reputation for judgment, skills, knowledge	1
Repeating revenue stream	0	Personal staff	1
Systems and organization	1	Personalized business name	0
Workforce in place	1	Work habits	0
Total enterprise attributes	3	Total personal attributes	6
Enterprise:	33%	Personal	67%
Total Goodwill	100%		

Full article linked here:
[BVU_1602_Gillmore.pdf \(bvresources.com\)](https://bvresources.com/BVU_1602_Gillmore.pdf)

How Do You Stay on Top of Case Precedent?

Sources

Publications

Speak to attorneys

Other?



Considerations & Potential Issues w/ Case Precedent

Very few cases actually make it to trial

.....

Dated

Differs from state to state

Facts and circumstances differ significantly from matter to matter

Lack of consistency

No one-size-fits-all approach, or even standardized methods

Common Battleground



Takeaways & Tips

Be cautious and aware of biases when discussing roles/involvement with management

Be aware of the double dip, or triple dip on key person risk, compensation and personal goodwill discount

Facts & Circumstances: Every matter is so, so different and case law is slim and not always comparable – know why or why not. Know the facts, background & timeline.

Market compensation used in valuation and % personal = separate...
....which amount is used for income determination purposes?

No one-size-fits-all approach, or even standardized methods

Family Law Services

Valuation Services

- Valuations of Businesses, Interests in Businesses, Professional Practices, and Sports Teams
- Valuations of Intellectual Property, Tradename, and Other Intangible Assets
- Valuations and Determination of Personal vs. Enterprise
- Goodwill and Active vs. Passive Appreciation
- Valuations of Compensation Agreements
- Valuations of Stock Options, Restricted Stock, Pensions, Notes, and Other Investment Assets
- Business Damages
- Lost Profits Analysis
- Assistance with Depositions, Mediations, and Trial Preparation
- Expert Testimony

Forensic Services

- Assistance with Financial Affidavits
- Equitable Distribution Analysis
- Lifestyle Analysis / Pay and Need Analysis
- Income Determination
- Alimony Scenario Analyses
- Classification of Assets and Liabilities
- Tracing Services
- Dissipation Analysis
- Business Disruption Analysis
- Damages Analysis
- Lost Profits Analysis, Lost Wages Analysis
- Assistance with Depositions, Mediations, and Trial Preparation
- Expert Testimony

Advisory Services

- Expert Witness Testimony
- Serving in Arbitration, as Court-Appointed and/or Mutually Agreed-Upon Experts
- Serving as the Financial Neutral in a Collaborative Divorce
- Assistance with Discovery
- Critique of Opposing Expert Reports
- Impact of Transactions on Valuation
- Economic Research
- Public Securities, Market, and Industry Research
- Assistance with Depositions and Cross-Examination
- Preparation of Demonstrative Exhibits for Trial
- Other Consulting Services



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