Bross Trucking Reaffirms *Martin Ice Cream*

By Robert W. Wood


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Robert W. Wood practices law with Wood LLP in San Francisco (http://www.WoodLLP.com) and is the author of *Taxation of Damage Awards and Settlement Payments* (2009 with 2012 supplement), *Qualified Settlement Funds and Section 468B* (2009), and *Legal Guide to Independent Contractor Status* (2010), all available at http://www.taxinstitute.com.

In this article, Wood discusses the sale of goodwill and the distinction between corporate and personal goodwill.

Doesn't everyone like ice cream? Perhaps not the IRS, at least not *Martin Ice Cream*.[1] That case involved creamy Häagen-Dazs and the prickly legal question of who owned the goodwill associated with an ice cream distribution business. The case is of continuing interest and remains nettlesome to the IRS.

Ever since the repeal of the *General Utilities* doctrine in 1986, the corporate and personal tax on selling a business has caused many to elect S corporation status or otherwise to reform their business structures. Putting all of one's eggs in one C corporation basket is increasingly inadvisable. Yet some closely held businesses remain as C corporations.

One reason may be easier accounting and tax compliance. Another reason may be a perception that there is no need for alternatives. Many closely held businesses pay out most of their income as reasonable compensation to employees, including shareholders.

In this situation, the owners may perceive that double taxation is not a problem. In an operational sense, it may not be. Selling out is a different matter. One reason the Service seems to have a particular dislike for *Martin Ice Cream* may be a view that large numbers of C corporation owners unreasonably rely on the case.

That may explain the Service's latest unsuccessful attempt to limit *Martin Ice Cream* in *Bross Trucking*.[2] Rather than helping the IRS to stamp out the offending personal goodwill doctrine, *Bross Trucking* did the reverse.

Original Flavor

In *Martin Ice Cream*, Arnold Strassberg sold the assets of Strassberg Ice Cream Distributors Inc. along with his personal goodwill to Häagen-Dazs. The Tax Court recognized that Strassberg's personal goodwill was a transferable intangible asset that he alone owned and sold. That meant one level of tax.

Strassberg worked in his own wholesale ice cream distribution business for over a decade. He personally developed strong business relationships with supermarkets. The founder of Häagen-Dazs approached him about distributing Häagen-Dazs products in supermarkets.

It was a handshake deal, and both parties did well. By the 1980s, Pillsbury Co. acquired Häagen-Dazs and approached Strassberg about acquiring his relationships with the supermarket chains. Pillsbury needed the contacts to sell Häagen-Dazs directly to stores. Pillsbury was willing to pay for Strassberg's connections but had no interest in buying Martin Ice Cream's assets.

As a result, Strassberg created Strassberg Ice Cream Distributors Inc., a subsidiary of Martin Ice Cream. He transferred his supermarket relationships to the new company. These relationships were the only assets of Strassberg Ice Cream Distributors. In a non-pro-rata exchange, Strassberg tendered his Martin Ice Cream shares for all of the stock of Strassberg Ice Cream Distributors.

Thereafter, Strassberg Ice Cream Distributors sold its assets to Pillsbury for $1.4 million. The IRS

[1] *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998); *see also* Robert W. Wood and Brian L. Beck, "State Law and Tax Treatment of Personal Goodwill, Part 1," *Tax Notes*, Jan. 14, 2013, p. 231; and Wood and Beck, "State Law and Tax Treatment of Personal Goodwill, Part 2," *Tax Notes*, Jan. 28, 2013, p. 483.

[2] *Bross Trucking Inc. v. Commissioner*, T.C. Memo. 2014-107.

said two levels of tax were payable and found this to be an inappropriate end run. However, the Tax Court held that the intangible assets embodied in Strassberg's oral agreements were not corporate assets of Martin Ice Cream.[3]

The Tax Court said no transfer of those goodwill assets to Strassberg Ice Cream Distributors could be attributed to Martin Ice Cream. The deal was simply outside the corporation. The IRS has done whatever it can to limit the holding in the case ever since.

Choice Ingredients

There are several striking facts about *Martin Ice Cream*. One is the lack of a written agreement between Strassberg and the corporation. Family-owned companies are often informal, yet it was clear that the company would have had a hard time enforcing any argument that the goodwill belonged to the company.

Strassberg personally developed business contacts and relationships. Without an employment or noncompete agreement the company could point to, the company simply had no legal rights to those contacts or relationships. That ownership feature is the root of the case. The company could not sell what it did not own.

The Service has tried to limit the case, but it is hard to tax a company on something it does not own. In 2012, *H & M Inc. v. Commissioner*[4] showed the continuing vitality and influence of *Martin Ice Cream*. *Bross Trucking* represents another important development that should help convince the IRS that personal goodwill is here to stay.

Who's the Bross?

Did Bross Trucking distribute appreciated intangible assets to its sole shareholder, Mr. Bross? Did Mr. Bross then give the assets to his sons? If so, should they have been reported as gifts made in 2004?

These may not sound like personal goodwill questions but the first one clearly is. In fact, it turns out to be the only important question in the case. And that really turns on a property law question: Who owns what?

Goodwill is an intangible asset. To address the tax issues, one must begin with who owned that asset and why. Mr. Bross founded Bross Construction in 1972, engaging in road construction for highway departments in Missouri, Illinois, and Arkansas. He was extremely knowledgeable about the road construction and personally developed relationships in the industry.

A hands-on owner, Mr. Bross was responsible for completing all projects his company undertook. This responsibility and control led him to found other businesses for his family. He had the same approach to fostering and maintaining relationships for other Bross family businesses.

In 1982 Mr. Bross organized Bross Trucking Inc. He did not have an employment contract with Bross Trucking and never signed a noncompete agreement. For that matter, none of Bross Trucking's employees signed noncompete agreements either. His three sons never worked for Bross Trucking.

Bross Trucking engaged in hauling materials and equipment for road construction projects. However, it went beyond handling solely family company projects and hauled coal in the winter for other customers.

Bross Trucking leased most of its equipment from another wholly owned Bross entity, CB Equipment. Bross Trucking paid for all fuel and maintenance for the leased trucks. It used independent contract drivers, not employees, to provide hauling services.

Relationships and Customers

When Mr. Bross started, trucking was highly regulated. In fact, Bross Trucking operated under Missouri's highly regulated rules for almost 30 years. That became increasingly problematic as the company faced fines and regulatory compliance problems. Throughout this time, as sole owner of Bross Trucking, Mr. Bross arranged the services for its principal customers.

These principal customers were Bross Construction, CB Asphalt, and Mark Twain Redi-Mix Inc. The latter was owned by Mrs. Bross and two of the Bross sons. In fact, Bross Construction, CB Asphalt, and Mark Twain Redi-Mix were all owned by Bross family members.

However, Bross Trucking did not have any formal written service agreements with Bross Construction, CB Asphalt, or Mark Twain Redi-Mix. Because of continuing regulatory problems, Mr. Bross decided to cease Bross Trucking operations. In July 2003, he and his three sons met with an attorney to discuss the best way to ensure that the Bross family businesses had a suitable trucking provider.

The attorney recommended that the Bross sons start a new trucking business. The three sons — previously uninvolved in Bross Trucking — created

[3]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").

[4]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).

LWK Trucking Co. Inc. This proved to be a different type of trucking company by providing more services than Bross Trucking.

New Dawn

The Bross sons used a different attorney, experienced in the transportation industry, to acquire the required authority, insurance, and safety inspections. LWK Trucking was organized on October 1, 2003, issuing Class A voting stock and Class B nonvoting stock. The Class A stock represented a 98.2 percent interest in LWK Trucking. The Class B stock represented the remaining 1.8 percent.

In December 2003, each of the Bross sons established a self-directed Roth IRA. Each son directed his Roth IRA to acquire 2,000 Class A shares in LWK Trucking. Together, the 6,000 shares acquired by the three Roth IRAs represented all of the Class A shares in LWK Trucking, giving the three sons 98.2 percent. The remaining Class B shares were acquired by an unrelated third party.

Mr. Bross was neither an owner of LWK Trucking nor involved in its management. LWK Trucking met all of regulatory requirements on its own, and nothing was transferred from Bross Trucking. LWK Trucking did hire several Bross Trucking employees, and by 2004, about 50 percent of LWK Trucking employees had worked for Bross Trucking.

LWK Trucking executed a new master lease with CB Equipment after Bross Trucking's lease terminated. At first, some of the trucks still displayed the Bross Trucking logo. However, regulatory scrutiny of the Bross trucks made it clear that LWK Trucking was also being tainted by the Bross name. LWK Trucking covered the old Bross logo with magnetic signs until the new company could have the trucks repainted.

LWK Trucking started with a similar business model to Bross Trucking but later expanded into other service lines. In 2004 LWK Trucking started and retained a controlling interest in One Star Midwest LLC, which provided GPS products to construction contractors. LWK Trucking also employed 11 mechanics to provide repair services to third parties. In contrast, Bross Trucking had used mechanics only to serve its rental fleet.

Corporate Distribution?

The IRS assessed a deficiency against Bross Trucking, claiming that it had distributed intangibles to Mr. Bross. The IRS said there was goodwill and suggested that it included these elements: an established revenue stream; a developed customer base; transparency of the continuing operations between the entities; an established workforce including independent contractors; and continuing supplier relationships. The IRS claimed that Bross Trucking distributed this goodwill to Mr. Bross who then gave it to his sons.

As the Tax Court noted, a corporation cannot distribute intangible assets owned by its shareholders. Thus, a key question was what Bross Trucking owned. This was the ultimate issue in *Martin Ice Cream*, in which the ice cream entrepreneur sold distribution rights and goodwill. In both *Bross Trucking* and *Martin Ice Cream*, the IRS claimed those were company assets.

The Tax Court in *Martin Ice Cream* held that without an employment or noncompete agreement, the company did not own the goodwill. The Tax Court in *Bross Trucking* found *Martin Ice Cream* analogous and contrasted it with *Solomon*.[5] In *Solomon*, the goodwill was developed and owned at the corporate level.

The Tax Court in *Bross Trucking* sought to reconcile these cases. It said the case law showed two regimes of goodwill: (1) personal goodwill, developed and owned by shareholders, and (2) corporate goodwill, developed and owned by the company. As in *Martin Ice Cream*, Bross Trucking's goodwill was primarily owned by Mr. Bross, so the company could not transfer it.

Corporate Goodwill

The Tax Court noted that Bross Trucking did have *some* corporate goodwill. But it was clear that regulatory problems, fines, and violations had rendered it of dubious value. In fact, Bross Trucking could not expect continued patronage — one of the classic formulations of goodwill — because customers did not want to continue doing business with it.

Indeed, LWK Trucking obscured the Bross name on its leased trucks. The explicit association with the Bross name was a negative, not a positive. To the Tax Court, this proved that any transferred corporate goodwill was more of a liability than an asset. Nevertheless, the Tax Court went on to consider some of the other hallmarks of goodwill.

For example, the Tax Court noted that Mr. Bross credibly testified that Bross Trucking had relationships with several national suppliers for fuel and parts. Even so, said the court, no evidence showed that LWK Trucking benefited from any transferred supplier relationships. The Tax Court found the only goodwill attribute the corporation could have distributed to Mr. Bross was a workforce in place.

Personal Goodwill

According to the court, the remaining attributes that the IRS claimed belonged to Bross Trucking were actually attributable to Mr. Bross's personal

[5]*Solomon v. Commissioner*, T.C. Memo. 2008-102.

relationships. Bross Trucking's revenue stream, customer base, and continuing operations were all spawned from Mr. Bross's decades of work in the road construction industry. He developed the crucial relationships with the business's customers. Without an employment agreement or a covenant not to compete, these attributes were his, not the company's.

The court was convinced that customers chose to patronize the company solely because of Mr. Bross's personally forged relationships. Even Bross Trucking's developed customer base was a product of his relationships. Mr. Bross was the primary impetus behind the Bross family construction businesses.

Instead of the web of Bross family businesses being a negative, it was clearly a positive. The court found that the transparency of the continuing operations among the entities was Mr. Bross's personal handiwork. His experience and relationships with other businesses were valuable assets but assets he owned personally.

A company does not have any corporate goodwill when all of the goodwill is attributable solely to the personal ability of an employee. None of the Bross sons contributed to Bross Trucking's goodwill. The sons were neither employees of Bross Trucking nor involved in its operations.

No Transfer of Personal Goodwill

A review of case law discussing personal goodwill shows a pivotal point is the presence or absence of an employment agreement or a covenant not to compete. Many taxpayers claim they personally own goodwill, an argument often thwarted by the presence of a binding employment or noncompete agreement.

In some cases, the taxpayer faces both. But Mr. Bross signed neither an employment contract nor a noncompete agreement. That was key. After all, a key employee who develops relationships for his employer may transfer goodwill to the employer through employment contracts or noncompete agreements.

An employer has not received personal goodwill from an employee when the employer does not have a right, contractual or otherwise, to the future services of the employee.[6] Mr. Bross had no employment contract with Bross Trucking and was under no obligation to continue working for it. He was free to leave the company and to take his personal assets with him.

Similarly, the lack of an employment contract showed there was no initial obligation for Mr. Bross to transfer any of his personal assets to Bross Trucking. Bross Trucking did not take an ownership interest in Mr. Bross's goodwill from the beginning because he never agreed to transfer those rights to the company. It could not happen by osmosis. According to the court, the lack of an employment contract proved that Bross Trucking did not expect to — and did not — receive personal goodwill from him.

Similarly, Mr. Bross never transferred any personal goodwill to Bross Trucking by signing a noncompete agreement. He was free to use his personal goodwill in direct competition with Bross Trucking if he stopped working for the company. That proved he did not transfer it to Bross Trucking.

An employee may transfer personal goodwill to an employer through a covenant not to compete, but that did not happen here. For stark contrast with *Bross Trucking*, consider *Howard*[7] and *Kennedy*.[8]

Asset Transfer?

A business cannot distribute assets that are personally owned by shareholders. Bross Trucking did not own, and could not transfer, Mr. Bross's goodwill. Nor did the company transfer a workforce in place. In fact, the Tax Court found there to be no evidence that Bross Trucking transferred any other intangible assets to Mr. Bross.[9]

The Tax Court recognized that there was one aspect of corporate goodwill that Bross Trucking displayed, and that was workforce in place. However, only approximately 50 percent of LWK Trucking's employees formerly worked at Bross Trucking. That did not seem to be a transfer of workforce in place to the court.

Instead, it appeared that LWK Trucking had assembled a workforce of its own, independent of Bross Trucking. The court found this to be demonstrated by new key employees and new services offered by LWK Trucking. LWK Trucking started One Star Midwest, which sold GPS services.

Moreover, LWK Trucking later started performing truck maintenance for third parties. Besides, these were just independent contractors choosing to accept work from a different business. That is not a transfer of workers.

The court went on to analyze other badges of goodwill. It noted that Bross Trucking did not transfer a developed customer base or revenue stream to LWK Trucking. Instead, Bross Trucking's

[6]T.C. Memo. 2014-107, at 28.

[7]*Howard v. United States*, No. 2:08-cv-00365 (E.D. Wash. 2010), *aff'd*, No. 10-35768 (9th Cir. 2011).

[8]*Kennedy v. Commissioner,* T.C. Memo. 2010-206; *see also* Wood, "The Emperor of Ice Cream, Dentists, and Personal Goodwill," *Tax Notes*, Nov. 15, 2010, p. 841.

[9]T.C. Memo. 2014-107, at 30.

customers had a choice of trucking options and chose to switch from Bross Trucking to LWK Trucking.[10]

The IRS argued that Bross Trucking's existing customer base was transferred to LWK Trucking, but the court was not convinced. The court found that Bross Trucking's customers were interested in changing trucking providers because of an impending suspension as a result of regulatory problems.

Customer Choice

This was simply not a transfer of intangibles at the service-provider level. Rather, it was a business choice made at the customer level. With the formation of LWK Trucking, Mark Twain Redi-Mix had the option to use a family-owned trucking company with an untarnished reputation and a clean service record. The court was convinced that Bross Trucking did not transfer its customers. Instead, the customers chose to use a new company because of Bross Trucking's troubled past.

Bross Trucking did not distribute any cash assets and retained all the necessary licenses and insurance to continue business. Mr. Bross remained associated with Bross Trucking and was not involved in LWK Trucking.

Accordingly, there was no transfer of intangible assets, and Bross Trucking remained a going concern. At the end of the day, LWK Trucking was independently licensed and developed a wholly new trucking company. LWK Trucking did not take a transferred basis in any assets. There was no indication that it used any of the relationships personally forged by Mr. Bross.

The Bross sons developed their own relationships. However, cultivating independently created relationships is not the same as receiving transferred goodwill. The Tax Court would not leap to conclusions that the IRS had not supported. True, LWK Trucking's and Bross Trucking's customers were similar, but that did not mean that Bross Trucking transferred goodwill.

Instead, the record indicated that LWK Trucking's employees created their own goodwill. The Tax Court found that Bross Trucking did not distribute assets to Mr. Bross. He did not give his sons the assets, so there was no gift that could be taxed either.

In short, the IRS was wrong. There was no gimmick in ownership. Without a noncompete or an employment agreement, the company did not own the goodwill. Mr. Bross did.

Conclusion

A sale of personal goodwill can sometimes provide a seller with a huge benefit: a payment outside the company reported by the individual as long-term capital gain. In some cases, this may seem like one more aggressive tax idea that can get people into trouble. True, the concept of personal goodwill is often misinterpreted and misapplied. When it is clear that the company owns the goodwill, and an employment or noncompete agreement may make this conclusion inevitable, there is little to discuss.

When a seller has unique skills and a strong personal relationship with customers distinct from the corporate goodwill, it is worth considering. A threshold question is whether the individual is bound by a covenant not to compete or employment agreement that gives some, or all, rights to the company. If the facts and documents line up, courts correctly uphold the sale of personal goodwill whatever the Service may say. In short, *Martin Ice Cream* is here to stay.

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[10]*Id.* at 31.