

## **TAX COURT CASE UPDATE**

### **Citation:**

*Bross Trucking, Inc. et al. v. Commissioner*, T.C. Memo 2014-107, June 5, 2014.

### **Overview:**

The Tax Court has ruled that a taxpayer's wholly-owned corporation that ceased operations due to its difficulty with regulatory authorities had no goodwill. As a result, even though the taxpayer's sons started a new business that had performed some of the same services and had some of the same customers as the father's corporation, there was no taxable distribution of goodwill from the father's corporation to the father and no gift from the father to the sons.

### **The Facts:**

Chester Bross ("Mr. Bross") owned 100 percent of Bross Trucking, Inc. ("Bross Trucking"); the corporation provided trucking services in Missouri. Ninety to 95 percent of Bross Trucking's customers were companies owned by Bross family members, including a road construction company owned by Mr. Bross.

Mr. Bross personally developed relationships with the necessary entities to work in the road construction industry. Further, Mr. Bross was responsible for fostering and maintaining relationships under the Bross family business umbrella to ensure that projects were successfully completed.

Mr. Bross did not have an employment contract with Bross Trucking, and he never signed a non-compete agreement that would prohibit him from competing against Bross Trucking if he disassociated from the company. The company leased its trucks from CB Equipment, another Bross family-owned entity.

In the late 1990s, Bross Trucking came under investigation by federal and state regulatory agencies for safety issues. Bross Trucking's customers questioned whether Bross Trucking would continue to offer trucking services because of the potential shutdown resulting from the pending regulatory proceedings. Mr. Bross decided to cease Bross Trucking's operations. However, Bross Trucking remained a viable entity, complete with insurance and its original trucking authority issued by the State of Missouri. On December 31, 2003, Bross Trucking had \$263,381.38 of assets, which consisted of accounts receivable, which it continued to collect, and cash assets; the cash assets were never distributed.

Because they wanted to ensure that the Bross family businesses had a suitable trucking provider, Mr. Bross's three sons, who were not previously involved with Bross Trucking, started their own trucking business in 2003 called LWK Trucking ("LWK"). In 2004, about 50 percent of LWK's employees were former employees of Bross Trucking. LWK executed a new master vehicle equipment lease with CB Equipment after Bross Trucking's vehicle equipment lease had terminated. The new lease allowed LWK to use equipment that had previously been leased to Bross Trucking. At the beginning of LWK's lease, some of the equipment still displayed Bross

Trucking logos because LWK did not have time to re-brand all of the trucks. Still believing those trucks were leased by Bross Trucking, the regulatory entities continued to closely monitor trucks marked with the Bross name, until LWK used magnetic signs to cover over the Bross name.

LWK provided a broader range of services than Bross Trucking, including doing truck repairs and providing GPS devices. LWK obtained its own licenses, regulatory authorizations, suppliers and customers. In other words, nothing was transferred from Bross Trucking to LWK.

The IRS assessed 2004 tax and penalties based on the following: a) Bross Trucking distributed appreciated intangible assets to its sole shareholder, Mr. Bross, and b) Mr. Bross then made gifts of those assets to his sons. The IRS said that the intangible assets had the following attributes: (1) established revenue stream; (2) developed customer base; (3) transparency of the continuing operations between the entities; (4) established workforce including independent contractors; and (5) continuing supplier relationships. Although the IRS did not call the intangible assets "goodwill," the court did.

### **Discussion:**

In the court's decision, it reasoned as follows:

*... Bross Trucking's goodwill was limited to a workforce in place.* Bross Trucking might have had elements of corporate goodwill at some point, but had lost most of it by the time of the alleged transfer. Specifically, through various regulatory infractions, Bross Trucking lost any corporate goodwill. The impending suspension caused customers to reevaluate whether to trust Bross Trucking and continue to do business with it. This is the antithesis of goodwill; Bross Trucking could not expect continued patronage because its customers did not trust it and did not want to continue doing business with it.

The lack of corporate goodwill was also demonstrated by the necessity to separate LWK from Bross Trucking by hiding the Bross name on LWK's trucks. That fact showed that any transferred corporate goodwill was not valuable and may have actually been detrimental to LWK. And trade names and trademarks are the embodiment of goodwill. Mr. Bross credibly testified that Bross Trucking had relationships with several national suppliers for fuel and parts, but no evidence was submitted showing that LWK benefited from any transferred supplier relationships. Further, it was unclear whether Mr. Bross or Bross Trucking cultivated the supplier relationships.

The Court concluded that the sole attribute of goodwill displayed by Bross Trucking was a workforce in place, and it was therefore the only attribute that the corporation could have distributed to Mr. Bross.

*...Nearly all the goodwill used by Bross Trucking was Mr. Bross' personal asset.* The remaining attributes assigned to Bross Trucking's goodwill all stemmed from Mr. Bross' personal relationships. Bross Trucking's established revenue stream, its developed customer base, and the transparency of the continuing operations were all spawned from Mr. Bross' work in the road construction industry. Any established revenue stream, developed customer base, or transparency of continuing operations was a direct result of Mr. Bross's personal efforts and relationships. Like the shareholder in *Martin Ice Cream Co.*, Mr. Bross developed the crucial relationships with the business' customers.

A company does not have any corporate goodwill when all of the goodwill is attributable solely to the personal ability of an employee. Unlike the taxpayer's products in *Solomon*, Bross Trucking's products did not contribute to developing the goodwill. This was demonstrated in part by the State of Missouri's deregulation of the trucking industry which allowed new entrants to easily begin trucking operations. In other words, it was not Bross Trucking's product which enticed customers to use its services because the services were not unique.

*...Mr. Bross never transferred his personal goodwill to Bross Trucking.* Mr. Bross did not transfer any goodwill to Bross Trucking through an employment contract or a non-compete agreement. A key employee who develops relationships for his employer may transfer goodwill to the employer through employment contracts or non-compete agreements.

Mr. Bross did not have an employment contract with Bross Trucking and was under no obligation to continue working for Bross Trucking. A contractual duty to continue to use his or her assets for the benefit of the company may show that an employee transferred personal goodwill to an employer for the length of the obligation. However, Mr. Bross was under no such obligation: he was free to leave the company and take his personal assets with him.

Mr. Bross never transferred any personal goodwill to Bross Trucking by signing a non-compete agreement. Mr. Bross' freedom to use his personal goodwill in direct competition with Bross Trucking if he stopped working for the company showed that he did not transfer it to Bross Trucking.

*...No intangible assets were transferred from Bross Trucking to LWK.* The only aspect of corporate goodwill that Bross Trucking displayed was a workforce in place. But Bross Trucking did not transfer an established workforce in place to Mr. Bross. The court said that it was unconvinced that most of a workforce in place was transferred when only 50 percent of the current employees were previously employed by the alleged transferor. Instead it appears that LWK assembled a workforce independent of Bross Trucking. This was evidenced by the fact that LWK hired many key employees for its new service lines. Bross Trucking did not perform these services and could not have provided employees to start the separate service lines. LWK may have hired former Bross Trucking employees, but there was no evidence that these employees were transferred to LWK, rather than hired away on their own merit.

The IRS's contention that Bross Trucking transferred a developed customer base and an established revenue stream was misleading because it suggested that the transfer was organized between Bross Trucking and LWK. It appeared, however, that Bross Trucking's customers were interested in changing trucking providers because of the impending suspension, showing that the act was not a transfer of intangibles at the service provider level, but a business choice made at the customer level.

Finally, Bross Trucking did not distribute any cash assets and retained all the necessary licenses and insurance to continue business. Further, Mr. Bross remained associated with Bross Trucking and was not involved in operating or owning LWK. He was free to compete against LWK and use every cultivated relationship in order to do so.

### **Conclusion:**

The Tax Court ruled that Bross Trucking's goodwill was primarily owned by Mr. Bross personally, and the company did not transfer any corporate goodwill to Mr. Bross in 2004. Thus,

there was no taxable distribution to Mr. Bross and no gift from Mr. Bross to his sons.