

Looking Anew at Noncompetes

Time can change everything, as can timing. Now that the payments by a business buyer for a covenant not-to-compete are no longer written off over the period of the covenant, why not call this complicated "rose" by another name altogether? Consider the name "goodwill." Since payments for both noncompetes and goodwill are currently being written off over a fifteen-year period, it makes just as much sense to call not-to-compete payments goodwill payments instead. The buyer doesn't have much incentive to do otherwise.

Is this change of name as good an idea for the seller? Not always: there are situations wherein the name switch may not be in the his or her best interest. This is especially important to note in regard to taxes. When the seller's business is a small C corporation, some tax can be avoided at the corporate level by the owner/seller being the direct recipient of the noncompete payments. This transferal of payment from the corporation to the owner, however, will work only if the noncompete situation is recognized to have true economic substance.

David Bishop, of the Bishop Law Firm, Charlotte, N.C., reports a recent Tax Court finding that clarifies the nature of a bogus noncompete. According to Bishop: "The court determined that payments to an ailing accountant couldn't be characterized as noncompete payments. Citing the accountant's age, serious medical problems and the fact that payments were to continue even if the accountant couldn't practice accounting or died, the court concluded that the non-compete [in this instance] lacked economic reality."