

Non-Compete Agreements in Business Sale Transactions: Buyer and Seller Considerations

Drafting Enforceable Restrictive Covenants, Optimizing Tax Treatment of the Agreements

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1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Non-Compete Agreements in Business Sale Transactions

Tax & Non-Compete Agreements

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Tax Issues: Context

- Employee Agreements
 - Issues with compensation
 - Expense Issues
 - Deduction methodology and amortization
- Purchase and Sale of Business
 - Issues regarding valuation
 - Treatment of income items
 - Capital Gain or Ordinary Income?
- Non-compete provisions in Deferred Compensation Agreements

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Employee Agreements: Tax

- Payment for signing non-compete provision
 - Legitimate business expense
 - Compensation to employee, income issue
- Accounting issues
 - Amortization requirements
 - Non-compete is an intangible under IRC Sec. 197
 - Amortize over 15 years
 - *Recovery Group, Inc., et al. v. Comr.*, TC Memo. 2010-76
 - \$400,000 paid to employee to sign non-compete.
 - Company should have amortized payment over 15 years as an intangible.

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Business Purchase and Sale: Tax

- Non-compete agreements as part of a business buy/sell
 - Treatments of payments for non-compete agreements
 - Ordinary income or capital gain
 - Usually ordinary income
 - Better for buyer, worse for seller
 - Expensed as incurred
 - Valuation
 - As personal goodwill
 - Capital Gain Treatment
 - Better for seller, worse for buyer
 - No expense deduction, no amortization
- Issue for negotiations

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Deferred Compensation Issues

- Issue with nonqualified deferred compensation plans
 - Usually supplemental retirement benefits for key employees, disability income benefits and, death benefits
 - Top-hat plans: 29 U.S.C. §1051(2)
 - Requirements: *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 11 (1987)
 - Key employee non-compete agreements
 - Violation of non-compete provision may result in termination of benefits as determined by plan administrator
 - Potential Conflict Issue
 - Severe penalty and tax consequences under IRC Sec. 409(a)
 - Severance payment in connection with a non-compete can be a violation if employee can influence year of payment

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Concluding Remarks

- Non-compete agreements have tax implications in three distinct contexts
 - In employee agreements
 - In Business buy/sell agreements
 - In nonqualified deferred compensation plan context for key employees
- Consult a tax advisor prior to finalizing a non-compete agreement
 - Tax advisor needs broad tax and business knowledge, including but not limited to, relevant income tax, corporate tax, and ERISA provisions.

Comments?

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