

Fall
2004

In This Issue

- Tax Free Exchange
- Valuing Goodwill
- Businesses For Sale
- Real Estate For Sale & For Lease
- Baby News



**Goodwill.
What is it?
How do you
value it?**

By **Scott Balfour**

Ask a banker, buyer, seller, accountant, lawyer, businessperson, or investor what **goodwill** is and you get some interesting answers.

Some might say goodwill is the result of a company being in business for a reasonable length of time, having a good reputation, a steady customer base, and reliable systems and people in place.

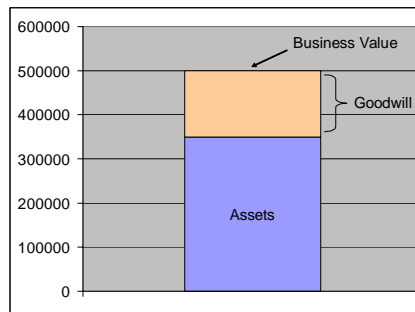
(That begs the question as to whether a bad reputation and poor management reduces the value of a business. Would that be negative good will? Yes, but oddly enough there are times when it wouldn't impact value. More on this later.)

Some say that goodwill is the intangible assets ~ they copyrights, patterns, records, files, customers, phone numbers, location, intuitional knowledge, etc. Again, not a bad definition. But how the heck do you put a value to that?

Others might suggest that a 'going concern' has goodwill because from the day the business is purchased, customers are coming through the door. The blood, sweat, time, good luck and/or foresight, along with the potential

operating losses that it takes to get a company up and running are minimized, if not eliminated. Anyone who has started a business knows how challenging the start-up process is.

Frankly, I'd have to say that each of these definitions partly describes goodwill. The problem arises when you have to put a value to it.



First, one needs to determine the value of the tangible assets of the business. This is the "stuff" that is used in the operation of the business as well as what is produced or sold by the business. Add up this value as if it were all to be instantly acquired, at its current used value, and dropped off in a new but identical location. This would be asset value. Now add the good will.

The goodwill value has to be determined indirectly. Let's start by saying **'the value of the business, less tangible assets, equals goodwill'**. A 'going concern' business is valued based on the cash flow it produces. It could be valued using a gross or net multiplier or perhaps some other formula.

Let's say the total value of the business is determined to be \$500,000. Subtract the value of the tangible assets, in this case let's say \$350,000. This leaves you with \$150,000 in goodwill. So you take all the subjective definitions of goodwill and it explains why \$150,000 in goodwill is real, legitimate and valuable. Why does it make sense to buy a business and pay for goodwill vs. starting a business from scratch? With startups you may not be able to draw a salary or pay expenses from day one. In addition, the

CONTINUED ON PAGE 2

Baby Girl Lily!



Please join us in congratulating our office manager, **Benita Dunton**, on the birth of a healthy baby girl! Lily Anna was born on August 13, 2004 weighing in at 7 1/2 pounds.

Enjoy your maternity leave, but hurry back - we miss you!

In the meantime, please know that our office is in the capable hands of Becky Hodges.



A Tax Haven For Preserving Real Estate Wealth

By Paul Lajoie

In the summer of 1990, the I.R.S. came out with the long awaited rules on Deferred Exchanges. Section 1.1031 of the Internal Revenue Service Code laid out the procedure for turning a sale and purchase type transaction into an exchange.

The 1031 exchange allows property owners to move up to bigger buildings increasing potential income and wealth without suffering the current burden of capital gains.

The 1031 tax deferred treatment of capital gains is one of the best real estate investor vehicles for preserving and building real estate wealth.

These new rules allow owners of certain types of like kind Real Property to sell their property and buy other like kind property without paying the Capital Gains Tax. It makes possible a transfer of the financial gain that is realized from the sale of a property into another property without federal capital gains tax at the time of the sale. The like kind provision for Real Property includes land, rental and business property, any of which can be exchanged for the other. The like kind provision for Personal Property is much more restrictive. This type of property must be in productive use in a business (depreciable property), and can be only exchanged for the same type of

property.

There are two qualifications beyond the property to carry an exchange through. First, an opening escrow must be established for the entire proceeds of the selling property to ensure tax deferment and second, you have only 45 days from closing to identify the replacement property and 180 days total to complete the closing of the replacement property.

There are strict guidelines to be followed in the process of a 1031 exchange and this should be handled by a qualified intermediary.

The 1031 exchange allows property owners to move up to bigger buildings increasing potential income and wealth without suffering the current burden of capital gains.

At Magnusson Balfour we pride ourselves in finding the right exchange properties to preserve your real estate wealth.

CONTINUED FROM PAGE 1

statistics regarding the number of start-ups that fail in the first three years is frightening. You reduce the risk of starting your new enterprise by buying a 'going concern'.

If you are considering selling your business, let us value it to ensure you receive the extra value (called goodwill) that you have worked to create.

If you are interested in finding a solid business, be sure to check in with us to view our listing portfolio. Stay tuned for our *Goodwill vs. Blue Sky* discussion in our next issue.

Featured Property



847 Gray Road, Gorham, Maine

This beautifully restored 6,500+sf Federal style building with new (reproduction) attached carriage house sits on 1.24+ acres. With ample parking and great signage, this is the perfect commercial space with residence! \$489,000. Contact Elisabeth Magnusson.