

32nd Annual Tax Symposium

NONCOMPETE AGREEMENTS IN BUSINESS TRANSACTIONS

By: Rita M. Lauer, Esq.

I. WHAT IS A NONCOMPETE?

- A. Contract between employer and employee prohibiting employee from engaging in various actions that may compete with the former employer.
- B. Currently, employer-employee noncompete agreement's validity is being challenged by the NLRB and Federal Trade Commission.
- C. Transactional Noncompete Agreements – No Challenge by NLRB/FTC.
 - 1. Noncompete clause found within the operating agreement, separate agreement with selling shareholder or member.
- D. Enforceable Noncompete for Business Transactions
 - 1. Bona fide requirements:
 - Acquired business is service or knowledge based,
 - former owner possesses knowledge,
 - former owner has long-standing relationships with suppliers or producers and/or
 - former owner has outstanding reputation/goodwill.
 - 2. Enforceability concerns:
 - Length of agreement,
 - scope of agreement (not overly broad) and
 - geographic scope of agreement.

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E. Taxation Considerations

1. Potential for double taxation on corporate-owned business assets
 - a. Who owns the intangible assets like goodwill/client lists
2. Covenants not to sue are intangible
 - a. Form 8594 to be filed by both buyer and seller.
 - b. 8594 is intended to report the transaction,
 - c. Penalties for failing to file by IRS

II. **CONCLUSION**

- ### A. Noncompete Clauses as part of transaction are valid
1. Substance of Agreement needs to meet “smell test”
 2. Who owns the intangible assets,
 - a. 15-year amortization
 3. File the 8594