

Current Valuation & Taxation Rulings Regarding Divorce

Valuation Date is Before The Date of Separation

In *Helene Rubens v. Robert Rubens*, No. 49450-3-I (Wash. App. July 21, 2003), unpublished, the Washington Court of Appeals considered whether the trial court appropriately valued a medical practice near in time to the date of separation. Throughout the marriage, the husband, a neurologist, operated a medical practice and earned over \$200,000 annually. In the year prior to the parties' separation, the husband decided to change professions and entered an MBA program. The husband planned to close the practice around the date of trial in August 2001. The trial court determined that the practice should be valued two months prior to the date of separation.

Both parties presented expert testimony regarding the value of the practice. The husband's expert valued the practice at \$223,214. This value included deferred taxes, which were treated as a corporate liability. The wife's expert valued the practice at \$292,702. Both experts agreed "as of August 31, 2001, the date that Dr. Rubens planned to close the practice, it would have no value apart from the actual physical fixtures and equipment." The trial court accepted the valuation offered by the husband's expert and he appealed.

On appeal, the husband argued that the lower court erred in setting the valuation date for the practice two months before the date of separation while using other valuation dates for other assets.

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Annual Payments Are Deductible As Alimony

In *Marlin G. Springer v. CIR*, T.C. Memo. 2003-221, the Tax Court considered whether annual payments made to a former spouse and labeled as alimony in the divorce instrument qualified as alimony for federal tax purposes. Under the divorce instrument the petitioner was to pay his wife \$1,500 per month for 120 months. The monthly payments would terminate upon the death of either party or the remarriage of the wife. The petitioner was additionally required to make five annual payments of \$50,000. The annual payments would not terminate upon the death of the petitioner or the remarriage of the former spouse. The annual and the monthly payments were labeled as alimony in the divorce instrument and were intended for "the support and maintenance of the wife." The petitioner paid the support due and deducted both the annual and the monthly payments as alimony under sec. 215 on his federal tax return. The IRS contested the deduction of the annual payment.

Before the Tax Court, the IRS argued that the annual \$50,000 payments did not qualify as taxable alimony under sec. 71 and were therefore not deductible to the petitioner under sec. 215 because the payments would continue after the death of the payee-wife. The Tax Court noted that

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Expert Testimony Would Have Helped Wife Establish Appreciation in Separate Property Business

In *Tina Marie Hudgens Stafford Gray v. Glen Allen Gray*, No. M2002-01365-COA-R3-CV (Tenn. App. July 31, 2003), the Tennessee Court of Appeals considered whether the trial court erred when it characterized an auto salvage business as the husband's marital property. The husband acquired an auto salvage yard in 1984. He paid \$149,500 for the business using a business loan, and collateralized a duplex he owned. The parties married in 1987. The wife performed some functions at the business during the marriage, but the degree of those contributions was a subject of contention. The parties also purchased nine additional acres adjacent to the salvage yard during the marriage. In 1995, the husband had a stroke and was no longer able to manage the salvage yard. His two adult sons from a previous relationship took over the management of the business. It was uncontested that the business declined following the husband's stroke.

The husband testified that the business was worth \$200,000 at trial. Neither party presented an expert who valued the business. The corporate accountant testified that the busi-

ness's profits steadily declined from \$162,000 in 1995 to a loss of \$19,000 in 2001. He testified that the business's income tax returns had not been filed since 1995 and the business's outstanding tax liability stood at \$61,000. Moreover, the business owed \$57,000 for advertising and \$5,000 in back workers compensation premiums.

The trial court determined that the salvage yard was the husband's separate property. It awarded the business and all its outstanding liabilities including the tax liability to the husband. It also awarded the husband the nine acres purchased during the marriage, but ordered that property be appraised and one-half the appraised value awarded to the wife. The wife appealed.

On appeal, the wife argued that the lower court erred when it characterized the salvage yard as the husband's separate property. She alternatively argued that the lower court erred when it failed to determine when the business appreciated in value during the marriage and to consider that appreciation in its property distribution. The appellate court disagreed. It found that since

the business was established before the marriage, it was not marital property. It further noted that the appreciation in the separate property over the course of the marriage may be marital property. However, it found that neither party established that the business had appreciated during the marriage. While the husband opined that the business was worth \$200,000, the court stated, "The testimony does not indicate whether his estimate was based on its value as a going concern or its liquidation value." It also stated, "More importantly, there is no indication that his estimate factored in the staggering debts of over \$120,000 that the accountant testified to." It lastly noted that the husband's opinion of value seemed to include the value of the nine acres acquired by the parties during the marriage, the value of which was divided between the parties. Thus, the court ruled, "it appears to us that the trial court did not err in determining that Ms. Gray is not entitled to any portion of ... [the salvage yard], other than the one-half share in the after-acquired real property that the trial court awarded her."

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The appellate court disagreed. It initially noted that the lower court has within its discretion the ability to determine the appropriate valuation date of each asset. It stated, "The [trial] court's decision to use the appraisal completed by Dr. Rubens' expert at approximately the time of separation took into account the decrease in the value of the practice by

the time of trial." It further stated, "The [trial] court considered the fact that the practice had significant economic value throughout the marriage and the decrease in its value was due to Dr. Rubens' own decision to close the business." The appellate court found that the commentary in *Washington Practice: Family and Community Property*, Kenneth W. Weber, sec. 32.7 (1997), supported this decision. It

noted, "The commentary explains that in a business where post-separation increase in value or loss in value is due primarily to the efforts of the managing spouse, the valuation date should probably be the date of separation." Thus, it affirmed the lower court's decision to value the practice near the date of separation when the husband planned to close the business near the trial date.

The brief summaries in this publication discuss only some valuation aspects of the subject cases and pronouncements. The reader is referred to the actual documents for additional details. This publication does not constitute legal, tax, accounting, or valuation advice, and it is offered as an informational service only. Those seeking specific advice should contact a professional advisor. No liability whatsoever is assumed in connection with use of this newsletter.

Expert Testimony Would Have Helped Wife Establish the Amount of Appreciation in Dental Practice

In *Joe B. Roberson v. Linda K. Roberson*, No. COA02-205 (N.C. App. May 20, 2003), unpublished, the North Carolina Court of Appeals considered whether the court erred in failing to calculate the appreciation in a separate property dental practice and distribute that appreciation. Before and during the marriage, the husband operated a dental practice. The parties agreed that the practice was the husband's separate property. The wife argued that the value of the practice grew through the efforts of both parties during the marriage, and that the increase in the value of the practice was active appreciation,

which is marital property. However, the wife failed to present any evidence showing the amount of the increase in value of the practice during the marriage. The trial court rejected her prayer for a share of the practice's appreciation because she failed to carry her burden of proof to establish the amount of the increase. The wife appealed.

On appeal, she argued that the lower court erred when it failed to characterize and value the appreciation in the dental practice. The appellate court rejected her argument. It initially noted, "[i]n order for the

court to value 'active appreciation' of separate property and distribute the increase as marital property, the party seeking distribution of the property must offer credible evidence showing the amount and nature of the increase." It then ruled, "Because defendant did not provide the necessary evidentiary basis for the trial court to find the amount of any increase in value, the trial court did not err in refusing to find any portion of the value of the dental practice to be marital property."

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in order for payments to qualify as taxable alimony, they must meet a four-prong test. The prongs are (a) the payments be made under a divorce or separation instrument, (b) the payments must not be designated as not subject to sec. 71 or sec. 215, (c) the payor and the payee must not be members of the same household, and (d) the payments must cease upon the death of the payee. The parties agreed that the payments meet the first three prongs of the test.

The Tax Court first noted, "In analyzing questions regarding termination of payments on the death of the payee, the statutory mandate of section 71 would have us first look at the language in the divorce instrument to

determine whether liability survives the death of the payee and, if the instrument is not clear, then determine whether such liability terminates at death by operation of State law." The Court then considered the two paragraphs discussing alimony in the divorce instrument. The paragraphs, one dealing with the monthly payments and one dealing with the annual payments, were significantly similar. It concluded, "the initial listing of three events causing termination followed by the parallel paragraph specifically excluding only two of those events from termination implies that the occurrence of the third event would continue to cause termination of the payments." Thus, it concluded that the annual payments would terminate upon the

death of the payee-wife.

The Tax Court additionally considered whether the payments would terminate under Nebraska state law. The Court found that under state law alimony payments terminate upon the death of either party or the remarriage of the payee spouse, unless otherwise agreed. The Tax Court determined, "The specific exclusion of two of the three events from termination, in this context, without reference to the third event, indicates that the third terminating event is still viable." Thus, annual payments would not continue under Nebraska law. Therefore, it concluded that the annual \$50,000 payments were alimony for federal tax purposes and deductible to petitioner under sec. 215.

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