

Current Valuation & Taxation Rulings Regarding Divorce

Credentialed Business Appraiser Accepted over Financial Analyst

In *Thomas Sanders v. Heidi Sanders*, No. CA03-738 (Ark. App. February 4, 2004), unpublished, the Arkansas Court of Appeals considered the valuation of a commercial plumbing business. The business was formed during the marriage. It was incorporated as a subchapter S corporation. It was capitalized with \$100,000 the husband received in an inheritance. The husband is the sole shareholder of the business and is employed there. The trial court appointed a credentialed business appraiser to value the business.

The court-appointed appraiser valued the business using the excess earnings method and the sales price to discretionary cash flow method. The expert determined that the business had no goodwill. She concluded that the business had a fair market value of \$29,000.

The wife also presented expert testimony from a financial analyst. This expert valued the business based on five-years average of cash. He concluded that the business had a value of \$240,000. This expert noted, "if he was selling a business he would use that method [that he used] and if [he] was buying the business he would use the method employed by ... [the court appointed expert]."

The trial court acknowledged that both experts' methodologies were appropriate for valuing the business in this case. However, it accepted the valuation of the court-appointed expert. In doing so, it stated, "The great value of ... [the court-appointed

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For Valuation Expertise...

Expert Valuation Testimony Would Have Been Helpful

In *Suzanne M. Amsbaugh v. Terry A. Amsbaugh*, 2004 ND 11 (January 14, 2004), the North Dakota Supreme Court considered a lower court's valuation of an interest in a marketing and advertising company. The business was started less than two years before the parties separated. The husband held a one-third interest in the business, which provided him a salary of \$25,000 per year. The husband's tax return showed that he earned a profit of \$13,000 from the business. Neither party presented expert testimony regarding the value of this business.

The wife valued the business at \$100,000. She started with the husband's reported earnings from his tax return. She then reasoned that since this business was riskier than placing the funds in a passbook account, which bore interest at three to five percent, it should provide a rate of return of 10 percent. She applied her rate of return to \$10,000 to arrive at her valuation. The husband did not provide an opinion of value as to the business. He provided the court with the business' financial statements, which showed that the business was operating at a loss and had a negative net worth. The trial court determined that the business "was just getting going but should continue to grow and recognized that its potential will be achieved only with a great deal of hard work." It then valued the business interest at \$1.00 and

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Expert's Thorough Goodwill Valuation Accepted

In *In re the Marriage of Wilson*, No. 21635-7-III (Wash. App. December 9, 2003), unpublished, the Washington Court of Appeals considered the valuation of goodwill in a psychology practice. Both parties were psychologists. During the marriage they established a practice through which both parties practiced. The wife left the business after the parties separated and established her own practice. Both parties presented expert testimony regarding the value of goodwill in each of their practices.

The wife's expert valued the goodwill using three methods: capitalized earnings using straight line and weighted average, and an excess earnings method. He averaged the results of the methods to arrive at a goodwill value of \$239,792, which he then allocated between the psychologists. He determined that the husband had goodwill of \$171,690.96 and the wife had goodwill

of \$68,101.04.

The husband's expert, an attorney and CPA, valued the goodwill using the five methods identified in *Marriage of Hall*, 103 Wn.2d 236 (1984). He also considered salary surveys that reported annual salaries for psychiatrists because no data was available for psychologists. He further considered the *Fleege* factors: the parties' age, health, past earning power, reputation and professional success. He utilized the parties' tax returns and data from the Institute of Business Appraisers. He concluded that under the *Hall* methods the parties had no goodwill, but considering other factors, he would accord goodwill of \$40,000 to the husband and \$20,000 to the wife.

The trial court accepted the goodwill values determined by the husband's expert. In doing so it noted, "... there was very little foundation for this

type of valuation; nevertheless, the court recognized ... [the husband's expert's] knowledge, expertise, and experience...." The wife appealed.

On appeal, the wife argued that the lower court improperly valued the parties' goodwill. The appellate court disagreed. It found that the husband's expert relied on a variety of resources to conclude that "no mathematical goodwill existed based on the accounting factors in *Hall*; yet, the parties possessed an expectation of continued public patronage that had a value", which he estimated at \$40,000 and \$20,000, respectively. The appellate court then noted that the expert considered the relevant factors and case law, and had sufficient experience and expertise in valuing goodwill; thus, it found that the lower court did not err in accepting the valuation put forth by this expert.

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expert] to both the plaintiff and the defendant is that ... [she] clearly ... explained why the company was worth what it was and gave the *actual income* of Tom Sanders." (Emphasis in original). It then awarded the business to the husband as his separate property, but awarded a portion of the business' income earned during the marriage to the wife. Both parties appealed.

The husband appealed the trial court's decision to award the wife income from the business when the business was established with nonmarital funds. The appellate court rejected his argument. It stated, "It makes little sense to hold that a spouse's earnings that were generated by significant amounts of his time, skill, and effort during the marriage are not marital property if they

are directed toward a business purchased with a gift of money." Thus, it affirmed the lower court's decision, which applied the presumption that earnings acquired during the marriage are marital property.

The wife appealed the trial court's valuation of the business. She argued that the lower court should have accepted the valuation offered by her expert. The appellate court noted that the primary conflict between the experts involved their treatment of goodwill. It stated, "...whether goodwill is marital property is a fact question, and a party, to establish goodwill as marital property and divisible as such, must produce evidence establishing the salability or marketability of that good-

will as a business asset." (Arkansas law requires a fair market value standard). The appellate court noted that the court-appointed expert valued the business without goodwill and the lower court determined that the business had little value without the services of the husband. It further noted that the lower court did not err when it chose to give more weight to the court-appointed expert's testimony than that of the wife's expert. It noted, "[the court appointed expert] is a certified business valuator, while ... [the wife's expert] has no training or expertise in that field." Thus, it affirmed the lower court's valuation of the business.

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Cross-Examination of Valuation Expert Considered

In *Charles A. Buzzanell v. Corina Miller (Buzzanell)*, No. COA02-1457 (N.C. App. January 6, 2004), unpublished, the North Carolina Court of Appeals considered the valuation of a medical practice. The parties were married for a mere thirteen months. During that time, the husband established a palliative care practice where the wife also worked full-time in an administrative capacity. Both parties presented expert testimony regarding the valuation of the practice.

The husband's expert valued the business at its asset value. He concluded that the business did not have any goodwill. Moreover, he stated, "As of January 31, 2000, the market for his practice would be almost non-existent." He concluded that after tax considerations, the practice had a value of \$31,000. The trial court rejected the opinion of value from the husband's expert. In particular, it found this expert's consideration of the tax consequences of a sale of the business speculative and his write-off ratios and collection deductions excessive.

The wife's expert valued the business, including goodwill, using the capitalization of excess earnings method. He relied on data from the practice for eleven months of its operation. He concluded that the practice had a value of \$180,165. He also confirmed this valuation with comparable market

data and a justification of purchase test. At trial, the wife's expert was questioned regarding whether the methodology he used in this case was consistent with the methodology he used in other cases. The trial court did not permit the husband's attorney to proceed with this line of questioning. It was further shown that the data the wife's expert used was actually from a full year rather than eleven months. The trial court also found that a \$10,103 loss should have been deducted in this expert's valuation, but was not. After correcting for the shortcomings it found with the wife's expert's valuation, the trial court relied on that expert's valuation to establish the value of the practice at \$155,048. The husband appealed.

On appeal, the husband argued that the trial court erred in accepting the valuation of wife's expert. The appellate court disagreed. It noted that while the business was established for only a short time, the capitalization of excess earnings method, which was used by the wife's expert, has been expressly adopted by the court for use in this situation.

The husband next argued that the lower court erred when it prohibited the husband's attorney from questioning the wife's expert regarding the consistency of the method used in this case as opposed to other cases in

which he testified. The appellate court affirmed the lower court's decision precluding this line of questioning. Citing *Power Co. v. Winebarger*, 300 N.C. 57 (1980), the appellate court noted that when impeaching a witness, "[a]ny further inquiry [beyond the scope of his knowledge] which states or seeks to elicit the specific values of property dissimilar to the [property] subject to the suit is at best mere surplusage." It further stated, "The questions asked by plaintiff on cross-examination of ... [the wife's valuation expert] regarding the valuation methodology he used in other cases and the values he came up with in those cases were 'mere surplusage.'"

The husband lastly argued that the lower court erred when it declined to consider the tax consequences as a distributional factor in determining the equitable distribution. The appellate court again affirmed the lower court. In doing so, it noted that the lower court found the husband's expert's testimony with regard to the tax consequences speculative. It further noted, "(1) no evidence was offered as to any anticipated sale of the PA ..., and (2) the court did not order the liquidation of property as part of the distribution. Thus, there was no abuse of discretion by the trial court."

(Testimony ... Continued from page 1)

awarded it to the husband. The wife appealed.

On appeal, the wife argued that the lower court erred when it valued the business interest at \$1.00. The appellate court noted that the lower court did not explain its valuation in rendering its opinion. It then considered case law in

which the appellate court affirmed the lower court's unexplained valuation when it was faced with incredible testimony and a questionable valuation method. It then affirmed the lower court's valuation in this case. It stated, "In this case, the district court had to choose between ... [the wife's] valua-

tion, which appeared to be mere speculation on her part, and financial records indicating that the business operates at a loss and has negative worth. Under the circumstances, we conclude the district court's valuation of the business was not clearly erroneous."

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.