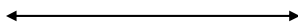


Current Valuation & Taxation Rulings Regarding Divorce

Expert's Valuation Accepted over Owner's Subjective Valuation



In *Dixie Lee Franks v. Billy Eugene Franks*, No. COA01-1601 (NC App. November 5, 2002), the North Carolina Court of Appeals considered whether the circuit court erred when it accepted the wife's expert's valuation of the husband's painting business over the opinion of value presented by the husband.

At trial, the wife presented a forensic accounting and business valuation expert. This expert analyzed the business's records regarding "accounts receivables, fixed assets, tax liabilities, expenses, customers, and other business components." He valued the business goodwill using an excess earnings approach. He determined the fair market value of the business to be \$450,000 using income and market approaches. The husband did not present any expert valuation testimony, but opined that his business was worth \$60,000. The court accepted the wife's expert's valuation and the husband appealed.

Before the appellate court, the husband argued that the trial court erred by accepting the wife's expert's valuation because the expert utilized the fair market value standard, which is defined as the "price at which property would change hands between a willing buyer and a willing seller...." He claimed that

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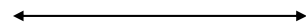
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Valuation Verdicts has been a popular newsletter for family law attorneys and will continue to be published by Jim Larson and LAS. New and past issues of *Valuation Verdicts* will be posted on the LAS web site, larsonappraisal.com. Quarterly notices will be sent to you when the latest newsletter becomes available. You may then download it and print it from your printer.

More information on Larson Appraisal Services or *Valuation Verdicts* can be found on the web at larsonappraisal.com

Asset Approach Used to Value Insurance Company

In *In re the Marriage of Cutler*, No. 5-01-0347 (Ill. App. 5 Dist. October 22, 2002), the Illinois Court of Appeals, Fifth District considered the valuation of a captive insurance agency. The husband was the sole employee and shareholder of an in-

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No Marketability Discount Applied to Bank Holding Company Stock

In *Jacqueline D. Baltrusis v. Ronald E. Baltrusis*, No. 48558-0-1 (Wash. App. September 16, 2002), unpublished, the Washington Court of Appeals considered whether a discount for lack of marketability should be applied when determining the value of closely held stock. Both parties held separate property minority interests in a closely held bank holding company. The holding company was owned primarily by members of the wife's family. The wife also held a minority interest in a limited partnership, whose only asset was stock in the bank holding company.

At trial, the wife presented expert testimony regarding the value of the bank holding company stock. The wife's expert, a CPA, considered an earlier appraisal, which concluded that the stock had a fair market value of \$13 per share, inclusive of a 33 percent lack of marketability dis-

count. The wife's expert concurred with the conclusion reached in that appraisal. The husband did not present any expert testimony. The trial court concluded that no lack of marketability discount was appropriate in determining the value of the bank holding company stock in this situation. It valued the stock by reference to the marketable minority value determined in the estate appraisal, \$19.50 per share. The lower court also declined to apply second tier lack of marketability and minority interest discounts to the limited partnership units. The wife appealed.

On appeal, the wife argued that the lower court incorrectly valued the bank holding company stock by failing to apply a lack of marketability discount. She further argued that the limited partnership units were incorrectly valued for the

same reason. The appellate court disagreed. It found that the value of the stock did not fall within the definition of fair market value because the husband was under a compulsion (i.e., a court order) to sell his stock to the wife, who was in a better position to enjoy the full value of the stock. It further noted, "In this regard, Ron [the husband] is in a situation somewhat similar to dissenting shareholders, who are 'unwilling sellers with no bargaining power.' [Case citations removed]. When appraising a dissenting shareholder's stock, courts determine fair value, not fair market value." Under the fair value standard, a lack of marketability discount is not generally permitted. Thus, the appellate court affirmed the lower court's valuation of the bank holding company stock.

Valuation of Business Required

In *Crystal L. Zalucha v. Matthew A. Zalucha*, No. 231441 (Mich. App. November 1, 2002), unpublished, the Michigan Court of Appeals considered whether the trial court erred when it failed to value the husband's business. The husband was a self-employed diesel mechanic. Neither party offered an expert appraisal of the business, nor did the trial court value the business. Nevertheless, the trial court set off the equity in the business against \$39,050 of the hus-

band's pre-marital equity in real property. The husband appealed.

On appeal, the husband argued that the lower court erred in setting off his pre-marital equity in the real property against his business when the lower court did not assign a value to the business. The appellate court agreed with the husband, noting, "Neither party offered any evidence regarding the actual value of the business, apparently because neither party wanted to

commission an appraisal." Thus, it reversed and remanded the property distribution. In doing so, the appellate court stated, "On remand, the trial court must value the business and may not include defendant's separate assets as part of the marital estate. ...the trial court may reopen the proofs so that an accurate valuation may be made."

"Valuation Verdicts" is a publication of Larson Appraisal Services (LAS). LAS provides a wide range of business and financial services including the valuation of businesses, business ownership interests, intangible assets, and financial litigation support. This work has been performed for a variety of businesses and for various purposes including divorce. The principal, Jim Larson, has been involved in preparation and defense of those valuations since 1993. For further information on Larson Appraisal Services please call 480-657-6219 or access the electronic brochure on the web at:

<http://LarsonAppraisal.com>.

Value of Cardiology Practice Reversed

In *Julian S. Eliz v. Connie Eliz*, No. 05-01-00085-CV (Tex. App. 5 Dist. August 19, 2002), the Texas Court of Appeals for the Fifth District considered the valuation of a medical practice. The husband operated a cardiology practice in Paris, Texas. The husband did not present expert testimony regarding the value of the practice at trial. The wife's expert, a CPA, valued the business based on future revenues. He looked at the husband's historical billing and rate of collection. He then projected that income stream into the future five and fifteen years to determine a value of \$4.3 million and \$13.1 million, respectively. The wife's expert stated and the trial court found that the husband had

frustrated attempts to discover information required to accurately value the practice. The trial court accepted the \$4.3 million value and awarded one-half that value to the wife. The husband appealed.

On appeal, the husband argued that the record did not support the trial court's valuation. The appellate court agreed. It found that the valuation presented by the wife's expert was flawed. It stated, "In short, ... [the expert] did nothing more than provide an estimate of Husband's personal future earning capacity; he did not provide testimony about the present value of the business." It then noted that a spouse is only entitled a share in the community assets at the time of

the divorce and is not entitled to share in the future income of the other spouse following the divorce. Thus, the court reversed and remanded the valuation of the business.

In reaching this decision, the appellate court rejected the wife's argument that the valuation should stand in light of the finding that the husband was a "recalcitrant and obstructionist litigant." It stated, "we cannot do as Wife urges and uphold the legal sufficiency of the evidence simply because Husband 'did everything he could to frustrate the process to arrive at the truth.'"

Goodwill Not Used in Mississippi

In *Dan H. Singley, Jr. v. Jane K. Singley*, No. 1999-CT-00754-SCT (Miss. October 17, 2002), the Mississippi Supreme Court ruled that goodwill may not be considered an asset of a private practice when determining the practice's value for equitable distribution purposes. The husband was a dentist engaged in private practice. The lower court appointed an appraiser to value the practice. The appraiser valued the practice using the asset approach and included a value for goodwill. The lower court accepted the court-appointed appraiser's valuation. The husband appealed to the appellate court, where he challenged the inclusion of goodwill in the valuation of his practice. The appellate court affirmed. The husband appealed to the Supreme Court.

Before the Supreme Court, the husband renewed his argument contesting the inclusion of goodwill in the valuation of his practice. The

Supreme Court agreed. It reasoned, "It becomes increasingly difficult for experts to place a value on goodwill because it is such a nebulous term subject to change on a moment's notice due to many various factors which may suddenly occur, i.e., a lawsuit filed against the individual or the death and/or serious illness of the individual concerned preventing that person from continuing to participate in the business. It is also difficult to attribute the goodwill of the individual personally to the business. The difficulty is resolved however when we recognize that goodwill is simply not property; thus it cannot be deemed a divisible marital asset in a divorce action." Thus, the Supreme Court reversed and ruled "goodwill should not be used in determining the fair market value of a business, subject to equitable division in divorce cases."

Expert's Valuation ...

Continued from page 1)

since he was willing to sell his interest in the business for \$30,000, he would be willing to buy the wife's interest in the business for the same amount. Therefore, he argued that his method was the best evidence presented at trial. The appellate court disagreed. It affirmed the lower court's valuation noting that the wife's expert used "valuation methods that complied with the standards established by law."

One judge, in a concurring opinion, noted that the husband did not object to the expert's valuation method at trial. Therefore, the judge reasoned that the husband should be precluded from arguing that the lower court erred in relying on the expert's valuation.

(Asset Approach ...)

Continued from page 1)

insurance agency servicing one insurance carrier (a captive insurance agency). Under his exclusive contract with the insurance provider, the husband did not own his book of business. At trial both parties presented expert testimony.

The wife's expert, a CPA, valued the business using a market approach under a fair value standard. He did not consider the effects of the husband's restrictive contract with his insurance provider. The expert determined that the business had a value of \$270,000. The husband's expert, a certified business valuator, rejected the market approach because he could not find any comparables. He also rejected the income approach because the husband did not own the book of business and therefore had no right to any future renewal commissions. Thus, he valued the business, using an asset approach, at \$32,000. The trial court valued the business using the capitalized returns method, which is a form of the income approach, to determine a value of \$243,000, assuming no need for the husband to sell or abandon the business in the future. The husband appealed.

On appeal, the husband challenged the valuation of the agency. The appellate court reversed the

lower court's valuation. It found that the capitalized returns method used by the trial court was improper because "the calculation would necessarily include as marital property labor which would be performed subsequent to the dissolution." It further noted that neither party presented evidence as to the value of the agency under that method.

It then reconsidered the experts' valuations. The court rejected the wife's expert's valuation because he did not arrive at the fair market value of the agency. It also took issue with the comparables used by this expert. It stated, "Because ... [this expert] used this rule of thumb (which applied to multiline and independent agencies), rather than actually determining the fair market value of the agency, we find that his valuation was not supported by proper evidence." It then accepted the asset valuation put forth by the husband. In doing so, it stated, "While the trial court expressly rejected \$32,000 as the valuation of the agency, neither ... [the wife] nor the court disputed that figure as the asset value of the agency." Thus, it reversed and remanded the equitable distribution.

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.