

## Current Valuation & Taxation Rulings Regarding Divorce

### Appellate Court Rejects Reliance on “Indication” of Value

In *Joyce Lynette Gohl v. Gerald Lee Gohl*, 13 Neb. App. 685 (July 5, 2005), the Nebraska Court of Appeals considered a lower court’s valuation of a closely held business. The business, Golight, had two units: a lighting manufacturing unit and a bed and breakfast unit. The lighting unit had been engaged in litigation over its patent with Wal-Mart. A year before trial, the lighting unit prevailed over Wal-Mart, obtaining a \$464,280 verdict, but that verdict is currently on appeal.

Both parties presented expert valuation evidence from CPAs with business valuation credentials. The husband’s expert presented an indication of value, which valued the business at \$505,283 as of May 31, 2001, before the Wal-Mart decision was obtained. Moreover, the expert valued the business as one consolidated enterprise.

The wife’s expert valued the business at \$2.041 million as of May 31, 2002, after the Wal-Mart verdict. He analyzed each business unit separately in arriving at his valuation conclusion. He issued an opinion of value.

The trial court adopted the husband’s expert’s valuation. The wife appealed.

On appeal, the wife challenged the lower court’s acceptance of the husband’s expert’s valuation. She specifically argued that the valuation was stale and failed to account for the Wal-Mart verdict. Additionally, she argued that the trial court erred when it rejected her expert, in part,

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### Private Medical Practice Valued under Holder’s Interest Standard

In *Susan M. Greenslait v. Michael W. Greenslait*, No. 254236 (Mich. App. July 7, 2005), unpublished, the Michigan Court of Appeals considered the valuation of a one-third interest in a medical practice. The parties married in 1990, after the husband completed medical school. By 1994, he completed his internships and residency and became a board certified anesthesiologist. Thereafter, the husband established a medical practice providing anesthesiology services to a hospital under an annual contract. The parties divorced in 2000.

The court received valuation evidence from four experts regarding the husband’s one-third interest in his medical practice. The court noted that the husband, through the company, had an exclusive contract to provide services to the hospital. The contract was renewed annually, but the husband was not in danger of non-renewal. The experts agreed that under this contract, the husband did not have any salable goodwill because the contract was non-transferable. Additionally, the experts noted that the husband’s annual income of \$292,000 in 2000 was below the mean salary for his specialty as reported by the Medical Group Management Association; therefore, he had no excess earnings. The experts agreed to the value of the practice’s physical assets,

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## Shareholder Loans Must Be Adequately Considered

In *Anna M. Lazarchic v. Raymond F. Lazarchic*, No. 0458-04-2 (VA App. July 26, 2005), unpublished, the Virginia Court of Appeals considered whether the trial court erred when it failed to adequately treat a shareholder loan. The parties owned a closely held business, which had real property. The parties agreed that the business was a marital asset. In contemplation of the divorce, the husband refinanced the property and retained \$350,000 of the proceeds. He executed a note in favor of the company in that amount.

Both parties engaged credentialed business appraisers to value the business. Both experts valued the business as of December 31, 2002. The wife's expert valued the business at \$276,956. The husband's expert issued a limited appraisal, which relied upon the assump-

tion that information provided by the husband was accurate. He determined the value of the business to be \$96,956. With respect to the husband's shareholder loan, this expert stated, "So he [the husband] borrowed it to create a liability, and it created an asset, the net worth of the company did not go up." The trial court valued the business at \$204,000, but did not either specifically include the value of the husband's shareholder loan in that valuation or deal with the proceeds of that loan as a separate asset. The wife appealed.

On appeal, the wife argued that the trial court erred when it valued the business without adequately treating the shareholder loan as an asset of the business or the proceeds as a marital asset in the hands of the husband. The

appellate court agreed. It found that whether treated as an asset of the business or a liquid asset in the hands of the husband, the \$350,000 was, admittedly, a marital asset. It further stated, "We do not follow the reasoning of husband's expert that husband created a personal liability to ... [the company], but the net worth of ... [the company] did not increase." It reasoned, "If the \$350,000 was a 'cash-out,' it remained marital property. If it was a loan from ... [the company], and a personal liability to husband, then the evidence of that indebtedness must be treated as a business asset, i.e., a receivable, thereby adding to ... [the company]'s value." Thus, it remanded the matter back to the trial court for adequate treatment of the shareholder loan or its proceeds.

## Mid-Size Service Business Has Enterprise Goodwill

In *Charles W. Rush v. Latresa A. Rush*, No. 2004-CA-00260-COA (Miss. App. August 9, 2005), the Mississippi Court of Appeals considered a trial court's decision to value an operating company inclusive of goodwill. During the marriage, the husband established a heating and cooling business that operated as a sole proprietorship. Late in the marriage, the husband merged his business into a corporation, and became a one-third shareholder in a larger heating and cooling business. The husband is responsible for managing the technicians and is the only shareholder with a heating and cooling background.

The husband filed for divorce in July 2002. The trial court appointed a CPA with business valuation experience to value the husband's one-third interest in the corporation. The expert determined

that the interest had a value of \$179,000, inclusive of business enterprise goodwill. He further determined that the business had little to no value associated with the personal goodwill of the husband. The trial court also received testimony to the extent that the husband was replaceable and that several of the business' employees could fill the husband's position. Therefore, the court adopted the expert's valuation. The husband appealed.

On appeal, the husband argued that the trial court erred when it failed to account for his personal goodwill in the business. The appellate court disagreed. It noted that the trial court appropriately differentiated the facts of this case from facts in *Watson v. Watson*, 882 So. 2d 95 (Miss. 2004), which held that neither personal goodwill nor enterprise good-

will should be considered when valuing a sole practitioner. Since this case involved a service business as opposed to a sole practitioner or professional practice, the lower court was correct in analyzing the goodwill. The appellate court further noted that the expert testified that \$120,000 of his value was attributable to business enterprise goodwill and very little or none of the value was attributable to personal goodwill. The appellate court concluded, "On all the evidence that was presented, the chancellor held that ... [the husband] was not an essential, irreplaceable part of ... [the business] and that the business would operate normally if ... [the husband] were to leave." Thus, it affirmed the trial court's valuation of this service business inclusive of business enterprise goodwill.

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**(Appellate Court ...** *Continued from page 1)*

because he separately valued each business unit.

The appellate court agreed with the wife's criticisms. It found that the husband's expert's report was stale in that it valued the business two years before the date of trial. It also noted that during those two years, the company had achieved a significant judgment against the Nation's largest retailer. Therefore, the husband's expert's valuation bore no relationship to the value of the company on the date of trial.

Additionally, it agreed that the Wal-Mart verdict should be considered in the valuation of this business even though that verdict is currently on appeal. In addressing this issue, the court noted that the husband's expert issued an indication of value, which is a limited appraisal form. As such, it contained a disclaimer that a more detailed investigation may have uncovered information that would have a material impact on his value. However, he testified at trial that his value would not have changed if he had issued an opin-

ion of value, which contained all the backup data. The appellate court stated, "Apparently, [the husband's expert] ... believes that for litigation purposes, the presence of 'all the backup details' is unnecessary. Such concept is obviously at odds with the written 'disclaimer' in ... [his] report..., where he admits that attention to more detailed information could have a 'material impact' on his indication of value. Similarly, the lack of detail materially impacts our ability to conduct effective appellate review." Thus, it found additional support for its decision that the husband's expert's valuation was unreliable.

Lastly, the court considered whether the lower court erred when it rejected the wife's valuation in part because her expert valued each business unit separately. It stated, "When the two components of Golight's operation are considered — a bed and breakfast and the manufacturing and retail sales of apparently useful tools—they could hardly be more different. Thus, assigning a separate value to each, and then combining the two for a

total valuation, is not unreasonable and illogical. It should be helpful to a fact finder to understand that the ... [bed and breakfast] is a component of Golight's business which negatively impacts its future prospects and, quite likely, its valuation." The court further noted that the husband's expert's report "contains no differentiation between the two components of Golight; nor does it value them separately. Thus, a reader of ... [this] report has little understanding of how ... [the husband's expert] actually treated the ... [bed and breakfast], and again our overall confidence in ... [this] valuation is further reduced." It concluded, "In our view, the failure of ... [the husband's expert's] report to separately analyze the two components of Golight ... is a serious flaw in the ... valuation."

Thus, the appellate court reversed the lower court's valuation and remanded the matter back to the trial court for a reassessment of the value of the business.

**(Private Medical ....** *Continued from page 1)*

but disagreed regarding the value of the husband's interest. The values were \$614,255; \$275,000; and two experts valued the interest at zero.

The trial court valued the interest under the holder's interest standard of value. It did not adopt any of the experts' opinions; rather, it applied a multiple of four, which was agreed upon by the experts, to incremental future earnings and added the husband's one-third share of the value of the physical assets to arrive at a value of \$136,000 for the husband's interest.

The husband appealed the trial court's value of his business interest. The husband argued that the lower court

"erred in developing a new, non-legal accounting methodology, and should be reversed." The appellate court disagreed. It affirmed the use of the holder's interest standard. It stated, "When 'it appears that [the practitioner spouse] would continue the ... practice, the valuation of the practice should be the value of the practice to [the practitioner spouse] as a going concern.'" The court further noted, "But we find no error in the trial court's logic that, apart from any possible goodwill value that might apply in the context of a potential purchaser, the anesthesiology practice still has significant value to defendant, espe-

cially in light of the facts that the evidence did not show that defendant intended to abandon the practice, and that, although defendant had an exclusive and renewable yearly contract with the hospital, defendant had popularity with the staff and the hospital administrator characterized him as a good anesthesiologist." Thus, the appellate court affirmed the lower court's valuation of the husband's interest in the practice at \$136,000, which was based on the various concepts and values contained in the expert testimony and the facts and circumstances of this case.

***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.***