

Current Valuation & Taxation Rulings Regarding Divorce

Expert's "Measurement of Value" Accepted over Owner's Opinion of Value

In *Duke Bowers Clement v. Janet Leigh Traylor Clement*, No. W2003-02388-COA-R3-CV (Tenn. App. December 30, 2004), the Tennessee Court of Appeals considered the amount of appreciation in a separate property business interest. During the marriage, the husband was employed and held interests in various businesses his family owned. At the time of the divorce, the husband held a 7.3 percent interest in one such company located in West Memphis, Arkansas. He was responsible for the company's construction division, which was one of five divisions. He brought this interest in the business with him to the marriage.

At trial, the husband testified to the value of the interest at the time of the marriage and at the time of trial. He did not present any expert testimony regarding the value thereof. He testified that the value of the interest was \$510,570 when he acquired it and \$715,000 at the time of his deposition. He relied on an appraisal performed by a CPA for the later value. However, that CPA's report was not entered into evidence nor did that CPA testify on the husband's behalf at trial.

The wife presented testimony from a CPA, who performed a "measurement of value." The husband moved to strike this expert because he did not perform an appraisal of the interest. The expert

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Tax Consequences of Speculative Future Sale Should Not Be Considered

In *Frank M. Johnson v. Sharon P. Johnson*, No. 246484 (Mich. App. November 18, 2004), unpublished, the Michigan Court of Appeals considered whether the tax consequences of a contemplated sale of a closely held company should be considered in the final valuation of that company for divorce purposes. The husband was an established architect who wholly owned a large successful architecture business in Ann Arbor. The parties separated in 1998.

At that time, they jointly retained a credentialed business appraiser to determine the value of the business as of November 30, 1999. The appraiser received information from the husband regarding his succession plan. The husband was 51 years old at the time of separation. He intended to phase himself out of the business by age 62, which he would reach in 2008, while maintaining an interest in the business. The parties later agreed to adjust the valuation date to June 30, 2001. This expert concluded that the business had a value of \$4.5 million.

During that time, the husband retained the same appraiser to determine the tax ramifications of his succession plan. This expert determined that it would be appropriate to take the tax consequences of the succession plan into effect in the value. He concluded

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Testimony Regarding Rate of Return on Public Securities Permitted in Connection With Capitalization of Earnings Valuation

In *Popham v. Popham*, No. S04F1553 (GA January 10, 2005), the Georgia Supreme Court considered whether a financial expert's testimony regarding certain publicly available securities was admissible in relation to his valuation of the husband's closely held business. At trial the husband presented expert testimony regarding the value of his business. The expert valued the business using a capitalization of earnings approach. He testified that "one of the capitalization method's components involves the consideration of the rate

of return and the risk factors connected with a closely-held corporation as compared to the rate of a Certificate of Deposit or the yield on a Treasury Bill." The wife objected to the introduction of this evidence. The trial court overruled her objection. She appealed that decision.

Before the Supreme Court, she argued that the trial court erred when it permitted the husband's expert "to refer to certain securities when testifying about the methodology he used to place a fair market

value on ... [the] business." The Supreme Court disagreed. It stated, "The facts upon which an expert bases his or her opinion are admissible on either direct or cross-examination, and such bases go to the weight given the testimony by the jury, rather than to its admissibility." Thus, it affirmed the trial court's decision to permit the testimony regarding the rate of return on securities when valuing a closely held business.

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stated that "the term 'appraisal' denotes a more far-reaching examination of a company's value than he carried out, one that would also involve an 'investigation of the profits in comparable companies and so forth.'" The trial court denied the motion to strike and permitted the testimony. This expert concluded that the interest had a value of \$1,118,893 at the time of trial. The wife testified that the interest had a value of \$640,909 when the husband acquired it.

The trial court did not make any finding of facts with regard to the classification or valuation of this business interest in fashioning its equitable distribution scheme. The wife appealed, and the appellate court reviewed this issue de novo.

The court first noted that the business interest was the husband's separate property having acquired it by

gift or inheritance. However, the appreciation in that business was the direct result of both party's active efforts – the husband's effort as an employee/owner of the company and the wife's effort on the domestic front. Thus, it concluded that the wife was entitled to 30 percent of the appreciation in the separate property business interest.

The appellate court then considered the amount of appreciation of that interest. It began by noting that neither party presented sufficient evidence from which to value the interest at the time it was acquired by the husband. Therefore, it accepted the opinion of value offered by the husband as to its value at that time "since he was in the best position to know its value."

The court next considered the testimony regarding the value of the interest at the date of trial. The appellate court first considered the husband's challenge to the wife's

expert because he did not perform an "appraisal" of the interest. The appellate court, like the trial court, noted that this challenge went to the weight of the evidence rather than to its admissibility. It then valued the interest by reference to the wife's expert's "measurement of value." In doing so the appellate court stated, "Because [the husband] ... did not introduce any documentary or testimonial evidence as to how he arrived at measurement of the value of his ... stock, while ... [the wife] introduced an expert report and testimony by ... [her CPA]—evidence that appears to be highly credible upon our review of the record—we conclude that the evidence preponderates in favor of the measurement of value offered by [the wife's] ... expert...." Thus, it concluded that the minority interest in the husband's family's business appreciated \$608,323 during the marriage, and awarded the wife 30 percent of that amount.

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<http://LarsonAppraisal.com>.

State Supreme Court Considered Dentist's Goodwill and Accounts Receivable

In *In re the Marriage of Schneider*, No. 97430 (Ill. January 21, 2005), the Illinois Supreme Court considered the valuation of goodwill in a professional practice. During the marriage, the husband acquired a dental practice. The wife agreed to waive maintenance in lieu of a disproportionate share of the marital estate including the dental practice. Both parties presented expert testimony regarding the value of that practice.

The husband's expert valued the practice at \$346,300 of which \$311,300 he attributed to the husband's personal goodwill. The remainder he attributed to tangible assets. This expert attributed no value to the practice's cash, accounts receivable, loans from shareholders, and cash surrender value of life insurance. The wife's expert valued the practice at \$481,000 of which he attributed \$144,413 to the tangible assets and assets omitted by the husband's expert. The remaining value he attributed to enterprise goodwill.

The trial court valued the practice at \$38,300 – the value of its inventory, furniture, and equipment. The wife appealed.

On appeal, the wife argued that the trial court erred when it declined to include any amount for goodwill or the accounts receivable and other omitted assets. The appellate court agreed, finding that the inclusion of the omitted assets and goodwill would not result in double counting with respect to the child support award when maintenance has been waived. The husband appealed.

The Supreme Court accepted the appeal. It found that personal goodwill (the ability to acquire future income) may not be included in the valuation of a professional practice when the maintenance or child support award is based on the payor-professional's income potential. The court ruled, "the personal goodwill in ... [the] dental practice was considered by the circuit court in assessing the criteria in section 503(d) and in deciding to award ... [the wife] a dis-

proportionate share of the marital assets. Any further consideration of that goodwill in valuing ... [the] dental practice would amount to an impermissible double counting." Thus, it reversed the appellate court's decision that held that personal goodwill should be included in the value of the practice.

However, it reached the contrary decision with respect to the accounts receivable and other omitted assets. It noted, "Although accounts receivable have not been collected, they are assets that have been earned and have a known value and, thus, are distinguishable from future earnings or income-generating ability. Because accounts receivable have a known value, a court can properly consider accounts receivable as assets of the business." Thus, it affirmed the appellate court's decision to include those assets in the valuation of the dental practice.

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that the tax consequences of the plan amounted to \$539,312.

The trial court received testimony regarding the value of the business from the appraiser. It adopted the \$4.5 million valuation determined by the expert. The expert further testified regarding the tax consequences of the husband's succession plan. The wife objected to this testimony. The court adopted that opinion as well, and reduced the value of the business to \$3.9 million. The wife appealed.

On appeal, the wife argued that the trial court erred when it reduced the

value of the business for tax consequences of the future disposition of the business under the succession plan. The appellate court agreed. It initially found fault with the lower court's analysis of the expert's testimony. It noted that the lower court erroneously concluded that the testimony regarding tax consequences was the product of the expert's joint engagement rather than testimony on behalf of the husband alone as the record clearly indicated it was.

In addition to its misunderstanding of the expert witness testimony, the appellate court ruled that the tax consequences of the succession plan

were too speculative to support a reduction in the value attributable to them. The court noted that the succession plan envisioned both the possibility of a taxable event as well as the husband's continued ownership of an interest in the business following his expected retirement at age 62. It further noted, "Frank cites no authority to support that taking into account tax consequences of a sale or succession of ownership that might possibly occur ten years hence is not speculative." Therefore, the appellate court reversed the lower court's reduction in value attributable to the future tax consequences.

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.