

## Current Valuation & Taxation Rulings Regarding Divorce

### Goodwill and Career Opportunity Foregone Considered



In *In re the Marriage of Field*, No. 19492-2-III (Wash. App. March 12, 2002), unpublished, the Washington Court of Appeals considered the lower court's valuation of a professional medical practice as well as its decision not to award any amount for career opportunities foregone. Both parties to the marriage were board certified medical practitioners: the husband was a surgeon and the wife was an anesthesiologist. The wife remained at home during the nine years prior to the date of separation while the husband expanded his professional practice. Both parties expressed a desire to work less and spend more time with their children. To that end, the husband reduced his workload following the date of separation.

The trial court received testimony regarding the valuation of the husband's goodwill. The husband's expert valued the goodwill using an excess earnings method, based on the husband's earnings for the two years prior to trial, 1998 and 1999. Using a multiple of three times excess earnings, the expert concluded that the husband's goodwill had a value of \$150,000. The wife's expert considered the husband's earnings over a five-year period. This expert used a multiple of five times excess earnings to arrive at a value of \$475,000 for the goodwill. The trial court used the husband's aver-

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Published By:

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### Sec. 1041 Inapplicable to Interest



In *Alexandra S. Yankwich v. CIR*, T.C. Memo. 2002-37, the Tax Court considered whether payments or some portion thereof the petitioner received from her former husband should be includible in her taxable income. The petitioner's former husband, a dentist, practiced through a corporation. The corporation in turn was a partner in a dental partnership. In 1992, the corporation's partnership interest was purchased. The corporation received an interest-bearing note in exchange for its partnership interest. The petitioner and her former husband treated the note as personal rather than corporate property. Under the petitioner's separation agreement, she would receive \$1,750 from the note's monthly payment, when and if received, until the note was satisfied or became uncollectible. Furthermore, under the separation agreement, the petitioner agreed that her CPA would determine the appropriate allocation between principal and interest she received for the monthly payments. She included the interest portion of the note payments as determined by the CPA in her taxable income for tax years 1995, 1996, and 1997. She further reported her share of the capital gains incurred by the corporation on the installment sale of the partnership interest. She later amended

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## Sole Proprietorship Valued Using Net Asset Method

In *Joyce Champion v. Gary Champion*, No. 98-P-808 (Mass. App. March 19, 2002), the Massachusetts Court of Appeals considered the valuation of a sole proprietorship. The husband sold and installed new and used telecommunications equipment through his sole proprietorship, Champion Resources. The husband presented expert testimony regarding the value of the business. His expert, a business appraiser, valued the business at \$54,000 using the net asset method (assets, including accounts receivable, less liabilities). He declined to include an amount for goodwill, determining that any goodwill was personal to the husband. The trial court accepted this expert's valuation. Both parties appealed.

On appeal, the husband argued that the trial court erred in valuing the business at an amount greater than zero. "Instead, he claim[ed] that because Champion Resources was worth

more to him as a stream of income rather than any amount for which he might have sold the business, he would not willingly sell Champion Resources no matter the sale price it might fetch." The appellate court rejected this argument. It stated, "In the absence of a determinable market value, experts commonly value a closely held business by the assignment of value to the assets of the business, as was done here ...". Since the trial court accepted the husband's expert's valuation, which was not clearly erroneous, the appellate court affirmed.

The husband also argued that the trial court improperly double dipped when it awarded the wife a share of the business's value and alimony since the business was valued in significant part using accounts receivable. He argued that "the judge's decision constitutes a 'redistribution through alimony and

child support [orders] of assets already assigned.'" The appellate court disagreed. It found that (1) the support orders were determined based on the husband's historical earnings as reported on his tax returns while the business's value was based on the business's future income stream, and (2) this argument fails to consider "the fact that as the receivables are being collected and converted into a stream of income, they are being replaced with new receivables." The court concluded, "Consequently, neither the value of the sole proprietorship nor Gary's ability to earn income is diminished by treating the business as a marital asset as well as a source of income by which Gary can meet his support obligations." Thus, the court concluded that the trial court was able to determine separate bases for the property division and the support payments from the same asset.

## Objections to a Valuation Must Be Raised Before the Trial Court

In *Leigh W. Walter v. James M. Walter, Jr.*, No. COA01-217 (N.C. App. April 16, 2002), the North Carolina Court of Appeals considered the valuation of an oral surgery practice. Both parties presented expert testimony regarding the valuation of the practice, and all the experts were admitted as experts in the area of the valuation of professional practices. The lower court accepted the valuation put forth by the wife's expert. The husband did not object to the admission of her expert's testimony or

report nor did he object to this expert's methodology or its application to the facts of this case. The lower court stated this expert's valuation was "not only based on accounting principles [] but also ... grounded in solid appraisal practice and common sense." The husband appealed.

On appeal, the husband argued that the methodology used by the wife's expert was flawed and thus the lower court erred in relying upon that methodology. The appellate court disagreed. It stated, "No objec-

tion was entered at trial to the valuation methodology utilized by ... [the wife's expert] or its application to the facts of this case. Thus, Defendant is precluded from challenging the trial court's valuation findings based on this methodology on the ground that it failed to 'reasonably approximate the net asset value of the [asset].'" Therefore, the court affirmed the lower court's valuation of the professional practice.

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**(Goodwill and Career Opportunity***Continued from page 1)*

age compensation from two years immediately preceding the date of trial (\$214,500) less the average employee salary (\$170,000) times a multiple of 4.5 to arrive at a goodwill value of \$173,250. In reaching this decision, the trial court determined that while the husband did not work as hard during the past two years as he had previously, the reduction in his workload was a good faith move to spend more time with his children. It rejected the wife's argument that the husband should not be allowed to voluntarily reduce his workload. The court noted that the question of how hard should a professional work was a philosophical question. It then determined that while the husband could work more and there was some support for the position that he should be credited with that increased work capacity, that there should be some sort of good faith reasonableness test when determining the professional's balance of work and home life. Thus, the trial court stated, "I find that Dr. Fred Field falls into that category. He is still working reasonable hours, given the rather substantial responsibilities he has with his children."

The trial court then considered the wife's claim for career opportunity foregone. It noted that this concept is "designed to compensate a spouse ... for foregoing career opportunities, that is, sacrificing her own professional development (and opportunities for increased professional

compensation) for the sake of the family." It noted that while Washington permits such a recovery, an award is not appropriate in this case considering both parties have medical degrees and the wife could be retrained within one year. It stated,

*Now, I realize to the extent Mrs. Allison Field gets back into practice, she starts out at somewhat of a disadvantage because she doesn't have the established practice that Dr. Fred Field has. But as I said in my decision, the problem with that analysis is that it is not a limiting factor. The limiting factor is that she wants to practice only part-time, certainly not full-time, because of the children. So to the extent she doesn't earn what an anesthesiologist would have been earning had she worked straight through, it's because she doesn't want to work full-time.*

Therefore, the trial court denied the wife an award for career opportunities foregone. The wife appealed.

On appeal, the wife argued that the lower court erred in its valuation of the husband's goodwill and in denying her an award for career opportunity foregone. The appellate court disagreed. It began its review by restating its standard of review:

"The question ultimately ... is not whether we would have viewed the evidence differently—as we may well have here—but rather, whether this judge made a principled decision." The appellate court then turned to the valuation issue. While the wife specifically argued that the lower court erred in using only a two-year basis for calculating the goodwill, the appellate court found that the lower court's valuation was "well within the evidence" presented to the trial court. The appellate court then considered an award for career opportunity foregone. It noted, "The judge here rejected not the concept of career opportunity foregone but rather its application to the particular facts presented by ... [the parties]." Considering the lower court's reasoning—both parties have medical degrees, the wife's ability to reenter her profession within one year, and their desire to spend time with their children—the appellate court affirmed the lower court's decision. It stated, "... while the denial of any award for the time Allison [the wife] spent raising children might strike some as unreasonable, the question is whether there are principled grounds for the court's decision. There are." Thus, the appellate court affirmed the lower court's decision with respect to the valuation of goodwill and career opportunity foregone.

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**(Sec. 1041***Continued from page 1)*

her tax return, requesting a refund of the capital gains taxes paid. She also claimed that she should not have been taxed on the interest portion of the note payments. The IRS disagreed.

The Tax Court noted that the petitioner received her right to payment under a separation agreement. It further noted that the payments qualified for nonrecognition treatment under IRC sec. 1041- transfers incident to divorce. The Court found that the petitioner had never held a beneficial ownership interest in the note. It further found that while there was no restriction on the transfer of the note,

a transfer was not made. It stated, "Since there was no transfer of the Note or of a beneficial interest in the Note, section 453B(g) [Gain or loss from an installment obligation] is not applicable in this case." Therefore, the Court agreed with the petitioner that she was not liable as a transferee for capital gains tax due on the gain from the sale of the partnership interest.

The Court then considered whether the interest portion of the payment was properly included in the petitioner's taxable income for the years at issue. The Tax Court stated, "We noted that section 1041

'does not provide for the exclusion of income; it provides for the nonrecognition of gain or loss under the circumstances described therein.'" The Court then reasoned "Petitioner acquiesced in the allocation made by ... [the CPA] as is evident by the fact that she included the amount of her proceeds allocated to interest on her respective Federal income tax returns." Relying on *Gibbs v. CIR*, T.C. Memo. 1997-196, the Tax Court held that the interest portion of the payment is includible in the petitioner's income while the principal portion is not includible in her income under sec. 1041.

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