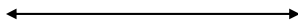


Current Valuation & Taxation Rulings Regarding Divorce

Failure to Have Business Valued Results in Malpractice Suit



In *Donna Sue Fischer Faris v. Thomas K. Stone*, No. 2001-SC-0864-DG (KY April 24, 2003), the Kentucky Supreme Court considered an attorney malpractice claim in connection with the failure to obtain a business valuation pursuant to a divorce. Stone, an attorney, represented Faris in her divorce. Faris's former husband held a 50 percent interest in six closely held companies. During property settlement negotiations, Faris' former husband represented that the businesses had an aggregate value of \$3,000. Faris received one-half this value in the settlement of the divorce. Stone did not obtain an independent valuation of the business or inform Faris of her right to have the business valued. Two years after the divorce was finalized, she learned that Stone had been negligent in failing to obtain the valuation. She brought suit against the husband in a CR 60.02 motion to reopen the divorce, but that motion was denied. Thereafter, Faris brought this malpractice claim against Stone.

Before the trial court, Stone argued that the statute of limitations on Faris' malpractice claim had run. Generally a malpractice claim must be filed within one year of the discovery of the claim. She argued that the statute did not toll until the CR 60.02 motion had been denied. The trial court agreed. A jury then determined that Stone had committed malpractice and that Faris would have

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ALIMONY?



In *Jane Gilbert v. CIR*, T.C. Memo. 2003-92, the Tax Court considered whether unallocated support payments made under a separation agreement qualify as alimony for federal tax purposes under section 71 and 215. The plaintiff and her former husband filed for separation in 1990 in Pennsylvania. In 1992, the Pennsylvania family court entered a support order. The order required the husband to pay \$2,177 per month in unallocated spousal and child support. The support order was cancelled in 1995. In 1993, 1994, and 1995, the husband reported all the payments as deductible alimony on his federal tax returns. The plaintiff did not include any amount received under the support order as income in her federal tax returns. The IRS took inconsistent positions with regard to the taxable nature of the payments to the plaintiff and her former spouse. The actions were consolidated and heard by the Tax Court.

The Tax Court first noted that in order for support payments to be treated as alimony for federal tax purposes, the payments must meet the four requirements of section 71. That section requires the payments to be (1) received under a divorce or separation agreement, (2) the agreement does not designate the payment as not includible in gross income under sec. 71 and not deductible from income under sec. 215,

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Opinion Testimony Did Not Establish Value—Business Valuation Ordered

In *Tracy Kelly v. Kimberly Kelly*, 2003-Ohio-612 (February 7, 2003), the Ohio Court of Appeals considered the valuation of a photography business. The husband started the business before the parties married. During the marriage, the business expanded into a significantly larger studio and purchased additional equipment. The lower court determined that the appreciation of the business during the marriage was marital property subject to distribution in divorce. However, neither party presented expert valuation testimony regarding the value of the business. Both parties presented opinion evidence as to the value of the business. The husband testified that he did not know the value of the business at the time of the marriage nor its current value, and he could only speculate as to the value of the

business's assets. It was further shown that the parties' living expenses (of approximately \$30,000 annually) were paid by the business. It was also shown that the business had one 'casual' employee and performed contracts for high school events. The wife was unable to place a value on the business or its assets. Based on this testimony, the lower court valued the business at the time of the marriage at \$1,000 and at the time of the divorce at \$3,400. It then awarded the wife one-half the appreciation. She appealed.

On appeal, the wife argued that the lower court abused its discretion in undervaluing the business. The appellate court agreed. It noted, "Each [of the parties] was competent to give opinions concerning the value

of the business, but neither did. Kimberly was unaware of its value. ... Tracy's testimony concerning the value of his business was so evasive as to be less than credible." Thus, the appellate court concluded that the lower court erred in assigning a value to the business based on that testimony. It then reversed the lower court's valuation. In doing so, it stated, "On this record, the [lower] court could perform its statutory charge to divide marital assets equally only by appointing a qualified, independent appraiser to provide the court a report on which it could rely. The appraiser's fee may be taxed as costs to the parties." Thus, it remanded the valuation back to the lower court with instructions to hire an independent appraiser to value the business.

Preuptial Agreement Set Aside when Actual Value Not Disclosed

In *William P. Postiy v. Cynthia L. Postiy*, 2003-Ohio-2146 (April 28, 2003), the Ohio Court of Appeals, Fifth District considered whether a prenuptial agreement should be enforced. The parties married in 1982. At that time, the husband held a 70 percent interest in a meat processing business. The business was insured for \$700,000. For the purposes of disclosing the value of his interest in the prenuptial agreement, the husband reported 70 percent of the insurance value. The business was sold in 1999 and the husband received \$670,000 for his interest. The parties filed for divorce in 2001.

Before the trial court, the wife argued that the prenuptial agreement should be set aside. She claimed that the value of the business interest re-

ported in the prenuptial agreement was not its actual value. She did not present any expert valuation testimony in connection with this claim. However, the husband admitted that the business could have been insured for \$1 million, but the \$700,000 value was used because he did not want pay for the extra insurance. Based on the undervaluation of the husband's business interest and the failure to report other assets, the prenuptial agreement was set aside. The husband appealed.

On appeal, the husband argued that the lower court erred in setting aside the prenuptial agreement because "assets disclosed by the appellant in connection with the agreement were not listed at their actual value, when there was no evidence

in the record that the actual value of the assets was substantially different from either the value stated by the appellant in connection with the antenuptial agreement or from the knowledge and understanding that the appellee had of the appellant's financial circumstances." The appellate court noted that a prenuptial agreement may be set aside when there was not "full disclosure, or full knowledge and understanding of the nature, value and extent of the prospective spouse's property." Here, the appellate court affirmed the lower court's decision to set aside the prenuptial agreement because the husband admitted to undervaluing the business interest in addition to omitting certain other assets.

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.

Without Expert Testimony, Law Firm Valued at Zero

In *Robert L. Schwartz v. Pamela J. Schwartz*, No. 231266 (Mich. App. March 20, 2003), unpublished, the Michigan Court of Appeals considered the value of a capital account in a law practice. The husband was an attorney in a highly specialized area of law. He held an ownership interest in the firm. He estimated that his capital contribution had a value of between \$35,000 and \$36,000. However, he further testified that the firm was not marketable to other attorneys because of its highly specialized niche, he had problems finding help, and it was

highly dependent upon his skills. Neither party presented expert testimony regarding the value of husband's investment in the law firm. Based on the evidence before it, the lower court determined that "there was no ascertainable marketable value to plaintiff's capital contribution account." The wife appealed.

On appeal, the wife argued that the lower court erred in failing to compensate her for the value of the husband's investment in the law firm. The appellate court disagreed. It noted, "A party seeking to include

an asset in the marital estate has the burden of proving the reasonable, ascertainable value of that asset." The appellate court further noted, "The evidence showed that plaintiff could not sell the shares he held in his firm. Moreover, plaintiff's practice depended principally on his own personal skills and expertise and was not marketable to other attorneys." Thus, it affirmed the lower court's determination that the husband's investment in the law firm had no readily ascertainable market value.

(Malpractice Suit ... Continued from page 1)

received \$162,100 as her share of the businesses if the divorce had been handled properly. Stone appealed.

On appeal, the court of appeals reversed the lower court's decision. It found that the statute of limitations began to run on the date the malpractice was discovered. Faris appealed.

The Supreme Court affirmed the court of appeals decision to reverse the lower court. It found that a CR 60.02 motion is an extraordinary procedure outside the appellate vehicle. The Supreme Court stated, "It is separate and distinct from the main case, and a party may not use it as a means to extend a statutory period." Thus, the Supreme Court concluded, "the latter of the date of occurrence or the date of discovery of the negligence commences the one-year statute of limitations." It noted that because Faris was unaware of the malpractice on the date of occurrence, the time when the underlying divorce became final, the one-year period commenced when she learned of the malpractice.

(Alimony ... Continued from page 1)

(3) the payor and the payee must not be members of the same household at the time the payments are made, and (4) there must be no liability for the payor to continue to make the payment after the death of the payee. The parties stipulated that the payments met the first three requirements, but disagreed over the fourth.

The Tax Court noted that whether unallocated support payments continue after the death of the payee spouse is a question of state law. It noted that the separation agreement was silent regarding the status of the payments after the payee's death. It further noted that the Pennsylvania Supreme Court had not addressed this narrow issue. It then found that Pennsylvania law in effect at the time the tax returns were filed was ambiguous on this issue. It noted that while under the law alimony payments would terminate upon the death of the payee, the family court would retain jurisdiction over child

support payments. Therefore, it reasoned that the unallocated support payments may continue beyond the death of the payee spouse. It stated, "Consequently, we have no reason to conclude that ... [the former husband's] obligation to make unallocated support payments under the ... separation instrument terminates upon the death of Ms. Gilbert." Therefore, it ruled that the fourth prong of the alimony test had not been satisfied, the support payments were not taxable alimony, and were properly excluded from the plaintiff's income.

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