

Current Valuation & Taxation Rulings Regarding Divorce

Request For Appointment of Independent Valuation Expert Should Be Made Prior to Trial

In *In re the Marriage of Windham*, No. A102414 (Cal. App. 1 Dist. October 29, 2004), unpublished, the California Court of Appeals, First District considered the valuation of a business. During the marriage, the husband acquired an interest in seven partnerships. Each partnership operated a Big O Tire franchise. The partnership interests were held by a corporation that was wholly owned by the husband. At the time of the divorce, the company owned between a 10 and 25 percent interest in each of the underlying partnerships. The company executed a note receivable to acquire the partnership interests, leaving the company with a \$650,000 liability. \$25,051.16 in principal had been repaid by the time of trial. In the event of default on those notes, the husband was entitled to a return of the principal paid thereon. Neither party presented expert testimony regarding the valuation of the company; however, the husband testified regarding the valuation thereof.

At trial the husband testified regarding the history of the business, its present financial condition, the general condition of each of the tire franchises, and the income produced by the franchises. He indicated that as a result of the downturn in the economy, the business had slowed. The company's liabilities exceeded its assets. He further testified that while the company had trouble paying him in the past, he had been able to draw a salary annualized to \$55,000 per year. He further testified that the com-

(Continued on page 2: **Windham**)

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For Valuation Expertise...

Doctor's Accounts Receivable Valued

In *Arthur Johnson, M.D. v. Renita Cotton-Johnson, M.D.*, No. CA03-1224 (Ark. App. October 6, 2004), the Arkansas Court of Appeals considered the characterization and valuation of a doctor's accounts receivable. In 2001, the husband, a neurosurgeon, joined a clinic. He was paid amounts based on the collected accounts receivable he generated. There was no documentation between the husband and the clinic or in the clinic's by-laws regarding ownership of the accounts receivable. However, the husband listed the accounts receivable as a personal asset on financial statements submitted to banks. Furthermore, the clinic had permitted a departing physician to retain his accounts receivable upon terminating his association with the clinic less amounts for collection fees and business loans.

The trial court determined that the accounts receivable were marital property. It valued the accounts receivable based on testimony from a CPA. The CPA reduced the gross accounts receivable by the historical collection rate (40 percent), by an amount for income taxes, and again by 15 percent for the clinic's collection fee. The CPA determined that the accounts receivable had a value of \$109,570 and the trial court awarded the wife one-half that amount. The husband appealed.

On appeal, the husband challenged
(Continued on page 3: **Johnson**)

In This Issue:

Request for Appointment of Independent Valuation Expert Should Be Made Prior to Trial.....1	Minority Interest Discount Rejected..... 2
Doctor's Accounts Receivable Valued.....1	Business Should be Valued by a Business Appraiser 2

Minority Interest Discount Rejected

In *Rosemary N. Haentjens v. Richard Peter Haentjens*, 2004 PA Super 398 (October 15, 2004), the Pennsylvania Superior Court considered the valuation of appreciation in a separate property business interest. In 1987, the husband inherited a 44.47 percent interest in a closely held business from his father's estate. For estate tax purposes, the stock had an undiscounted value of \$2.181 million and a fair market value, including a minority interest of \$711,459. In 1994, the company was sold. In 1996, the husband received \$2.194 million for his interest as a result of this sale. That year the wife filed for divorce.

At trial in 2002, the wife and the husband presented expert testimony regarding the amount the stock appreciated between the date of inheritance and the date of sale. The wife's expert subtracted the stock's 1987 fair market value from the undiscounted, after tax value of the proceeds the husband re-

ceived in 1996. He concluded that the stock appreciated \$1.149 million during the marriage. The husband's expert calculated the appreciation using book value. He subtracted the 1987 fair market value of the stock from the book value of the after tax proceeds received by the husband in 1996. He concluded that the stock had appreciated by \$5,144. The special master accepted the calculation performed by the wife's expert. However, the trial court rejected that calculation. It calculated the appreciation based on the pre-tax undiscounted value of the stock in 1987 and the sale proceeds received in 1996. It determined that the stock appreciated \$12,763 during the marriage. In making this calculation, the trial court "emphasized that pertinent financial data concerning the Company supported using this method of valuation, as that data demonstrated that the value of the Company had been fairly stable over the period in

question." The wife appealed.

On appeal, the wife argued that the trial court erred when it rejected the master's acceptance of her expert's appreciation calculation. The superior court disagreed. It noted, "The error in using this method of assessment [used by the wife's expert] is that it effectively compares apples to oranges: the initial valuation, assessed in the context of an estate administration, incorporated a substantial minority discount, while the ultimate 'value' received certainly did not contain such a discount as the entire business was sold." Thus, the superior court affirmed the trial court's calculation of the appreciation in a separate property minority interest in a closely held business without reference to a minority interest discount when the appreciation is measured by reference to an arm's length sale of the entire business.

(Windham... Continued from page 1)

pany had no current value, but he would receive a return of the principal paid on the notes used to purchase the partnership interests in the event of default. The husband further submitted the company's federal tax returns as evidence of its current financial health. The wife did not object to this testimony. She did move for the appointment of an independent appraiser to value the business. The trial court denied that motion, and valued the business based on the husband's testimony. It concluded that the business had a value of \$25,051.16. The wife appealed.

On appeal, the wife argued that the trial court should not have permitted the

husband to testify regarding the value of the business, should have appointed an independent appraiser, and erroneously valued the business. The appellate court disagreed. It initially noted, "as the sole shareholder, officer and employee of BWI, [the husband] ... was competent to testify to the value of BWI." It further noted that the wife waived this argument when she failed to object to the husband's testimony before the trial court. It next considered whether an independent appraiser should have been appointed. The appellate court noted that appointing an independent valuation expert was within the trial court's discretion. Fur-

thermore, the trial court's decision should be affirmed because the wife did not request such an appointment until the close of trial and because the husband's testimony provided substantial evidence to affirm the trial court's valuation. Thus the appellate court affirmed the lower court's valuation. In doing so, it stated, "Because the only evidence in the record is that BWI was not entitled to the return of any interest in the event of forfeiture under the purchase agreement, the trial court reasonably limited ... [the wife's] share to only one half of the principal payments."

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Business Should Be Valued By A Business Appraiser

In *In re the Marriage of May*, No. A04-438 (Minn. App. October 19, 2004), unpublished, the Minnesota Court of Appeals considered the valuation of a bait shop. The parties acquired a 50 percent interest in the shop and its real property in 1992. The husband's parents held the remaining interest. The parties engaged a real property appraiser to value the shop and real estate. The appraiser briefly visited the business and briefly discussed the business with the husband's father. The appraiser did not place a value on the business' inventory. He valued its furniture and fixtures at \$6,000. He concluded that the business had a going concern value of \$0. At trial, both parties contested the valuation of the business. The husband argued that the fixtures and equipment were valued at \$8,140 while the wife argued that they had a value of \$47,850. The wife further argued that the business had inventory worth \$200,000, while the business' balance sheet showed inventory worth \$74,237. The parties further argued whether \$20,000 provided to

them in connection with the purchase of the business was a loan from the husband's grandmother or a gift.

The trial court first determined that the \$20,000 was a gift rather than a loan. In reaching this determination, the trial court noted that (1) there was not a written loan agreement, (2) no payments had been made on the loan since 1996, (3) a loan was not listed as an asset of the grandmother's estate upon her death, and (4) the wife testified that the loan was to be forgiven upon the death of the grandmother.

The trial court next considered the appraiser's valuation. It found that the appraiser's report was incomplete, which was further supported by the parties' arguments regarding the value of the fixtures and equipment. It noted "the report's departure from recognized appraisal processes, the limited amount of time the appraiser spent in the store and the brevity of the appraiser's discussion with ... [husband's father]." The court then valued the business' fixtures and equipment at \$25,000 and included the balance sheet's value of

the business' inventory.

The husband appealed to the Minnesota Court of Appeals where he argued that the trial court erred when it failed to treat the \$20,000 from his grandmother as a loan, departed from the appraiser's valuation, and included amounts for inventory. The appellate court disagreed. It affirmed the trial court's reasoning with respect to its determination that the contested amount was a gift. It affirmed the lower court's decision to accord the valuation report little weight because it was incomplete. The appellate court noted, "Even ... [the husband's] valuation [of the fixtures and equipment] is higher than that offered by the appraiser, suggesting an acknowledgment that the report is inaccurate." Thus, the appellate court affirmed the lower court's decision. It stated, "The [trial] court's explanation of its rationale presents a reasonable basis for doubting the report's credibility and selecting another value."

(Johnson... *Continued from page 1*)

the characterization of the accounts receivable and their valuation. The appellate court first noted, "Accounts receivable are an asset subject to division upon divorce, with their net present value to be divided between the spouses." It then rejected the husband's argument that the trial court mischaracterized the accounts receivable as marital property because they were the property of the clinic. It found that the accounts receivable were properly characterized as marital property because (1) no documentation supported the position that the accounts receivable belonged to the clinic, (2) the

clinic paid the husband the full amount of his collected accounts receivable after taxes and a collection fee, (3) the husband listed the accounts receivable as personal assets on his financial statements and (4) the clinic permitted a departing physician to retain his accounts receivable less certain deductions.

The appellate court next addressed the valuation issue. The husband argued that the accounts receivable should have been valued in the same manner as when the clinic permitted a departing physician to retain his ac-

counts receivable. The appellate court agreed. Thus, it further reduced the value of the accounts receivable as determined by the wife's CPA by the husband's share of the clinic's business loan (\$32,900). After determining the accounts receivable had a value of \$76,670, it awarded the wife one-half that amount.

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.