



Divorce Roundup: Best (and Worst) Practices for Valuing Small Businesses

A summary of recent cases highlight both the best and worst practices for valuing small businesses in divorce, including the benefits of using an experienced BV expert; the possible limits to using a joint expert; and the continuing complexity of valuing goodwill and tax/marketability discounts.

Joint experts in divorce: When to seek a second opinion? In *Cox v. Cox*, 2011 WL 208312 (Miss. App.)(Jan. 25, 2011), a joint expert valued the husband's structural steel company at \$4.3 million before the marriage and \$4.9 million at the end, but discounted the latter by 50% due to declining industry and company conditions. At trial, the wife argued the expert should have discounted the premarital value of the business as well, but the trial court accepted the expert's reasoning and the wife appealed. On review, the appellate court affirmed that the value was supported by "substantial evidence" from the joint expert, including his conclusion that the closely held steel company "lacked an active market" and was "by definition . . . illiquid." Moreover, the wife had "ample opportunity" before trial to present her own evidence on the premarital value of the company, but failed to do so, and the court affirmed the finding of no appreciation.

Courts prefer credentials, compliance, and experience. In *Nuveen v. Nuveen*, 2011 WL 988826 (N.D.)(March 22, 2011), the husband presented a certified appraiser to value his orthodontic practice; the wife presented a lawyer-broker, who typically appraised dental practices. Both experts considered the husband's purchase of intangible assets three years before the divorce—but only the broker doubled that value, due to the practice's consistently high earnings. The trial court found the husband's expert more credible, not only because he was certified and prepared his report according to BV professional standards, but his intangible value was more accurate given the flat market conditions. The court declined to apply the expert's 12% marketability discount, however, and the appellate court confirmed, finding the valuation was within the range of evidence presented by both parties.

By contrast, in *In re Marriage of Bruns*, 2011 WL 237969 (Iowa App.)(Jan. 20, 2011)(unpub.), the husband presented a broker-expert who valued his dental practice at \$77,000. But this was only slightly higher than the \$75,000 that the husband had paid for the practice 30 years before, and it excluded goodwill. The wife's expert, a certified appraiser, said the practice was worth \$241,000, including goodwill. The trial court valued the practice at \$115,000, finding the

broker understated the value but the BV appraiser had limited experience valuing dental practices. The appellate court affirmed, noting that the value complied with state precedent regarding the exclusion of professional practice goodwill.

Also of note: In *In re Marriage of Meek-Duncomb*, 2011 WL 768831 (Iowa. App.)(March 7, 2011), the wife presented a CPA to value the husband's trucking business at \$145,000. But the CPA admitted he did not perform "certified valuations," and the trial court found his opinion was "less credible than a business audit." It valued the husband's semi-truck at less than \$10,000, and the appellate court affirmed.

Has Mississippi muddied the goodwill waters? Mississippi and Kansas are the only two states that still decline to assign any value to the goodwill of a marital business. In *Rhodes v. Rhodes*, 2011 WL 80222 (Miss. App.)(Jan. 11, 2011), the Mississippi Court of Appeals recited the long-standing precedent: "goodwill is simply not property; thus it cannot be deemed a marital asset," in affirming the trial court's rejection of an expert who failed to exclude goodwill or assign it a separate value in his appraisal of the husband's home furnishings business. A strong dissent argued that a proper reading of state law precludes goodwill only from professional practices.

However, less than a month later, the Mississippi Supreme Court decided *Lewis v. Lewis*, 2011 WL 322410 (Miss.)(Feb. 3, 2011), which said the law of the state is "clear and comprehensive," and "*stare decisis* demands" the valuation of the parties' real estate firm, excluding any goodwill. The issue may not be so settled; two Supreme Court justices dissented, arguing that general accounting principles support valuing a business's intangible assets, including goodwill.

Tax and other discounts depend on facts. In *Shuck v. Shuck*, 2010 WL 206845 (Neb. App.)(Jan. 25, 2011), the Nebraska Court of Appeals held that discounting the value of a marital business for built-in capital gains tax liability is relevant only in two situations: when the sale of the business is reasonably certain to occur in the near future; or when liquidation is necessary to satisfy the owner-spouse's financial obligations in divorce. At the same time, tax adjustments to the entity's cash flow streams under the income approach are proper, because these relate to the business's obligation to pay annual, ordinary income taxes rather than to any built-in depreciation or capital gains tax realized on sale. Lastly, the court affirmed that under state law the application of minority and marketability discounts to the value of a marital business falls to the trial court's discretion, depending on the particular facts of the case.

Uncooperative owner-spouse may hurt his own appeal. In *Salumbides v. Salumbides*, 2011 WL 835102 (Neb. App.)(March 8, 2011)(unpub.), the husband failed to disclose sufficient financial information to value his neurosurgery practice. The trial court conceded the difficulty, and ultimately valued the practice at a “significantly low” \$155,000 based on the wife’s appraiser’s assessment of accounts receivable and tangible assets. The husband appealed the value for lack of support, but the appellate court affirmed, noting that he could hardly complain of a situation he helped create.