Why is this Valuation Different
Than All Other Valuations
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It is possible that more business valuations are done for and in the context of divorces than for any single other reason. We practitioners follow well established procedures for doing business valuations. However, the field of divorce presents a plethora of unique issues, some of which really have nothing to do with the technical aspects of business valuation. Nevertheless, these become significant in the valuation process and in the ultimate either settlement or adjudication of the business valuation aspects of a divorce case. In some ways, divorce business valuation is like no other valuation.

- There is likely no real transaction – unlike when a business is being valued for a sale or purchase, in a divorce there is no real transaction, even though one party is going to be bought out of his/her interest in the business entity.

- No matter what the rules are, Courts often create their own sense (and blend) of value. Sometimes, with opposing experts, one expert is accepted over the other; sometimes the infamous compromise is made, which has perhaps no foundation in business valuation theory; and other times judges will pick and choose pieces of different valuations and then fashion them together in some sort of conclusion.

- Equity, or some interpretation of same, can be a driving factor in determining the value of a business. Divorce goes through a court of equity. As such, there are times when overriding issues intervene to set aside what would otherwise be a sound valuation approach.

- Absolutely unique to the divorce process, the buyer of an interest in the business often has to continue to support the seller's lifestyle.

Another unique aspect of divorce valuation deals with situations where part or all of the interest being valued was received via gift or inheritance during the marriage, or perhaps even prior to the marriage. We are now no longer dealing merely with the value of the interest at the Date of Complaint, but with the value of the interest at multiple points in time, and whether or not the appreciation (if any) in that interest is subject to distribution (that is, did the interest increase in value during the marriage – and in the hands of the owner of that interest, was said interest an active asset).

None of those issues actually change the theory or procedure of what we need to do. However, the multiple valuation issues, and the matters of appreciation in excess of the value at a certain point in time and active versus passive are divorce only situations. In addition, we are sometimes faced with arguments, some creative, some not, over whether or not the gift (or inheritance) was actually valid. For instance:

- Was it really a gift, or was it an interest in the form of sweat equity – and this actually disguised compensation? If it was sweat equity, then the value at the time of the putative gifting was in the pot (or perhaps some if not all of it?) since it was really equity that was paid for during the marriage by efforts made during the marriage realized in the form of an interest in a business instead of dollar compensation.

- Putting aside whether anyone could argue that it was disguised compensation, if we are faced with what we are told were gifts, where is the proof that they were gifts. Were gift tax returns ever filed. Does it matter whether or not they were ever filed. Gift tax returns need not be filed if the gift is worth less than $10,000. Who determined what it was worth – especially if there was no gift tax return filed, there was also probably no formal valuation done at that time. Does it matter? And, just how much proof or support does one need to prove that it was gifted – even if there was a gift tax return, and especially in the absence of same.

We are also faced with very practical issues when it comes to these multiple valuation dates. One such issue is the cost of doing the valuations. Particularly in a small situation, particularly with a relatively minor interest, the cost of doing more than one valuation can be in excess of what most of us would consider justified for the value of what is at hand. Another such issue is trying to do a valuation going back several, 10 or even 20 years. Are the records available. How are we supposed to value a company 10 years ago if no one has retained financial statements or tax returns. What information exists upon which we can rely. Even if financial statements and/or tax returns are available, are they in the same format and condition as is current; what about the underlying books and records – how are we supposed to do any form of a forensic or due diligence analysis and examination. And, how far do we carry this expensive exercise. Again, these are practical issues that are unique to divorce – having nothing directly to do with the theory of valuation.

To further complicate this already confusing area, regardless of whether or not we can determine (using concrete supporting documentation) the change in value during the marriage, isn't there the overriding issue as to whether in the hands of the divorcing spouse there is (has been) an involvement in the business being valued that renders that interest, as to that spouse, an active asset. If not, if no such involvement exists, then likely that interest is a passive one – and any appreciation accordingly passive. If the interest is separate property, and the involvement (lack thereof) of a passive nature, then it would appear that whatever appreciation there is, it too is separate property – not part of the marital estate.

Finally, another truly unique divorce issue, the infamous "double dip". In any valuation but a divorce valuation we merely have to value the interest at hand. We do whatever we have to, including addressing the issue of reasonable compensation. In a divorce context, the person buying out the interest is also often called upon to maintain the lifestyle enjoyed during the marriage – to pay alimony, support or whatever. A problem arises, in the eyes of some, when we realize that it is the same "excess" income used in determining value, that same income which has created value, that is also being used at the same time for support. Is that fair – or is it a double dip. If it is a double dip, how do we address it.

We have issues here that we find nowhere other than in the divorce context. Yes, that same "excess income" that helped to create value is being used for support. However, that source of income (the business) remains, and there is (isn't there?) a reasonable prospect that over time its income will increase. Also, it is possible to value a business without addressing the issue of owner's compensation. For instance, some businesses can be reasonably well valued using a top line (gross revenues) approach. This totally ignores the issue of the compensation taken by the owner.

In addition, is the very real issue that regardless of whether it is excess income, reasonable or unreasonable compensation or whatever, it was just that compensation, in its totality, that was used to maintain the marital standard of living. If we are to give priority to the marital standard of living, then what do we do to the value of the business; if we are to give priority to the value of the business, and we are concerned about the double dip, do we then impoverish the spouse (and the children ?) because of a fear of an alleged double dip. Do we give the spouse being bought out a smaller percentage – but is that fair. Do we lower the support number for a few years – but is that fair. Do we do nothing – but is that fair?

Clearly, divorce valuation faces a dichotomy. There are a multitude of issues in divorce which have resulted in approaches and considerations having nothing directly to do with valuation theory. There are practical as well as human interest issues.

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