Equitable Distribution and Professional Practices: Case Specific Approach to Valuation

By Joseph W. Cunningham

There are presently differing views among divorce lawyers and valuation specialists in Michigan regarding the use of the "holder's interest" value—a measure of value often used to appraise professional practices for divorce settlements.[1] This split of opinion is centered on the issue of whether, for equitable distribution purposes, a professional practice should be valued based on the economic benefits it provides the owner—hence, "holder's interest" value, or what it could be sold for—that is, fair market value.

With this prevailing controversy in mind, this article focuses on the suitability of, and support for, the holder's interest value for professional practices in divorce settlements. In doing so, the following is presented:

- The "case specific" approach to value for divorce settlement purposes generally and the corresponding suitability of the holder's interest value in particular for equitable distribution of a professional practice where there is no indication the practice will soon be sold or discontinued;
- The growing base of support for the holder's interest value both in case law and among renowned divorce valuation specialists; and
- Response to questions raised about using the holder's interest value for divorce settlement purposes.

WHAT IS THE APPROPRIATE APPROACH TO VALUE FOR DIVORCE SETTLEMENT PURPOSES?

In General

Fair market value (FMV) is a widely recognized standard of value. Federal tax authorities use it for establishing values for estate and gift tax purposes. FMV is defined as:

> *"...the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts."*[2]

By definition, FMV is a price that would result in an arm's length transaction. Thus, it is a sale-based measure of value.

Have Michigan courts adopted FMV as the general measure of value to be used for divorce settlement purposes? The evidence suggests the answer is "no." In fact, Michigan courts embrace no one single measure of value to be arbitrarily applied on a broad brush basis.

Rather, consistent with the nature of divorce as a matter in equity, the valuation of marital assets is generally performed on a case specific basis, taking into account the type of property and the circumstances of the parties. This is appropriate since in most cases the marital assets are not being sold and converted to cash, but rather are being divided between the divorcing parties. Thus, the emphasis in equitable distribution is the value to the parties involved in the subject divorce, not to a hypothetical third party, except where there is evidence that property will be sold, which sometimes occurs as a result of the divorce (*e.g.*, a large family residence that neither party can afford on his or her own).

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In other words, divorcing parties own property which has had a value to them during their marriage. The process of equitable distribution attempts to divide that same value between the parties following the dissolution of their economic partnership. If some marital assets will be sold, then the relevant value is FMV. If, however, other property that will not be sold has a higher value in the hands of the party who will continue to own it than could be realized on a sale, then equity suggests using the higher value in the divorce settlement.

The following are some examples of the application of the above principles of case specific value, rather than arbitrary use of FMV for equitable distribution purposes:

• **Potential Selling Expenses**—Where there is no indication that property, such as a marital residence, will be sold in the foreseeable future following a divorce, it is generally considered inappropriate to reduce its appraised value by the cost of selling the property (*e.g.*, commissions).

• **Nonmarketable Retirement Benefits**—Even though pensions and IRAs cannot be sold or pledged, their value is not generally reduced by a discount for lack of marketability. Such a discount would be appropriate if the standard measure of value was the sale-based FMV rather than the value to the owner.

• **Taxes on "Built-In" Gain**—Neither is the value of property generally reduced by capital gains taxes that would result on disposition unless there is evidence suggesting the property will be sold in the near future. This takes on added significance considering that the leading cause of malpractice claims against family law attorneys is the failure to appropriately take taxes into account when fashioning marital settlements. In fact, many practitioners "cover the tax base" by extending to the party taking property with built-in taxes a credit equal to the present value of taxes that would result on a sale at a likely disposition date in the future. But, if FMV was the standard measure, the value of property would be reduced by the taxes resulting from a hypothetical current sale, not the present value of future taxes.

One of the most compelling recent illustrations of the case specific approach, which trial courts use in exercising their wide degree of discretion in dividing marital property, involves the early retirement assumption concerning the value of pensions. In its 1988 *Kilbride* decision, the Michigan Court of Appeals ruled that the pension of a divorcing party should be valued under the assumption that he or she would elect to draw the pension at the early retirement age under the plan.[3]

Early retirement benefits often contain a substantial subsidy from the employer, provided as an incentive to encourage early retirement. For this reason, and also because the pension will be paid over a considerably longer period of time (*e.g.*, ten additional years if payments begin at 55 instead of 65), the present value of early retirement benefits is typically much higher than the value under a normal retirement age assumption. The Court of Appeals adopted this approach based on an article by a nationally renowned divorce pension specialist who stated that the early retirement age assumption should be used since it was then that the value of the pension came under the control of the participant spouse.[4]

The *Kilbride* decision was criticized because arbitrary application of its approach results in the nonemployee spouse receiving half the value of an early retirement subsidy that the employee spouse never receives if he or she does not elect early retirement, which many individuals cannot afford to do (often because of financial obligations of the divorce).

Applying the holder's interest measure of value to a personal service business such as a professional practice is simply an extension of the principles of case specific valuation commonly used by trial courts . . .

The *Kilbride* early retirement assumption was expressly overruled by the Court of Appeals in its *Heike* decision.[5] In *Heike*, the court stated as follows:

> *"While* Booth *did not specifically reject the proposition in* Kilbride *that the earliest possible retirement date must be used when valuing a pension, we do so now. Circumstances often exist that would make it unrealistic to assume that an employee will retire at the earliest possible retirement date. Utilizing a fictitious date results in a fictitious value for the asset. To value a pension based on this required assumption of retirement in the face of contradictory evidence will necessarily result in an unfair or inequitable distribution of this marital asset. The trial court is in the best position to determine the proper date and method of valuation based upon the circumstances of each case. See* Booth, supra *291. We therefore hold that no one valuation method is required, but rather the trial court, when valuing a pension, is obligated to reach a fair and equitable division of the property in light of all the circumstances."* (Emphasis added.)

Thus, after having adopted an approach to valuation that was arbitrary and which did not allow for value to be determined according to the circumstances of the parties, the court reversed itself by reasserting the appropriateness of valuing property on a case specific basis consistent with the principles underlying equitable distribution. This requires more consideration of the facts and circumstances, and more need to exercise judgment. But, isn't this exactly what should occur—determining an equitable distribution of marital assets based on their values to the owners, appropriately taking their circumstances into account?

Suitability of Holder's Interest Value

Applying the holder's interest measure of value to a personal service business such as a professional practice is simply an extension of the principles of case specific valuation commonly used by trial courts in dividing marital assets under equitable distribution principles. Stripped to its core, the holder's interest value means that:

(1) If an interest in a personal service business is worth considerably more to the owner (a) under the assumption that he or she will continue to operate the business—and, accordingly, continue to reap the financial benefits it provides, than (b) assuming the owner will sell the business to a third party (*i.e.*, FMV),

(2) then the appropriate value for divorce settlement purposes, that is, for determining the offsetting amount of cash or value of other property for the nonowner spouse, is the value to the owner, not the lower FMV.

This is not a radical departure from the case specific methods of valuation for divorce settlement purposes that have evolved and become generally accepted such as those described previously. Rather, adoption of the holder's interest measure of value simply brings into conformity the valuation of personal service businesses with the way most other marital assets have been valued for years. The objective is to prevent one party from receiving a windfall at the other's expense (which can easily result if FMV is used where there is no indication of a sale)—the same objective the court in *Heike* had in rejecting *Kilbride*'s arbitrary early retirement assumption.

To illustrate, if the owner of a professional practice—such as a doctor, lawyer or accountant—receives a substantially higher financial return from his or her practice than could be received from the sale of the

practice (as is commonly the case), it is reasonable to believe that the professional will continue to operate the practice since that is in his or her best economic interest. *And, if the practice was established during the marriage, that is during the economic partnership of the parties, would it be equitable to make an award to the nonprofessional spouse based on the practice's FMV even though it will continue to provide substantially higher benefits to the professional after the divorce?* The answer is self evident as is, correspondingly, the equitable underpinnings of the holder's interest measure of value.

SUPPORT FOR HOLDER'S INTEREST VALUE—MICHIGAN CASES

The 1986 Michigan Court of Appeals *Kowalesky* decision is generally regarded as the first in Michigan to suggest that a professional practice should be included in the marital estate at its value to the owner-professional absent evidence that he or she intended to sell or discontinue the practice.[6] *Kowalesky* has been followed by two subsequent Court of Appeals decisions, *McNamara*[7] and *Johnson*.[8] These three cases are the only ones to date to address the issue of value to the owner-professional versus a sale-based value in a divorce context. The following examines these decisions.

Kowalesky

The *Kowalesky* case involved the value of a dental practice. The trial court used the $110,000 value determined by a specialist in selling dental practices who had applied a 40% distress sale discount to the goodwill of the practice which he believed would result from an immediate sale. Without commenting specifically on the terms "FMV" or "holder's interest value" (or other similar terms such as "value in use" or "ownership value"), the Court of Appeals remanded the valuation of the practice to the trial court with the following instruction:

> *"There is nothing in the record to support the assumption that the plaintiff would discontinue his practice or that the staff would not stay on. Since it appears that the plaintiff would continue the dental practice, the valuation of the practice should be the value of the practice to plaintiff as a going concern."*[9] (Emphasis added.)

It was later revealed on remand that the trial court's $110,000 value (although the same as that computed by the expert) was in fact based on a going concern premise and was *not* affected by the expert's "distress sale" discount to goodwill. Rather, the trial court apparently arrived at the same value by taking other adverse economic factors into account.

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This misunderstanding by the Court of Appeals of the trial court's approach to value does not, however, blunt the court's unequivocal direction that, because there was no indication the practice would be sold or discontinued, the appropriate value was "the value of the practice to plaintiff as a going concern." Moreover, the court's decisions in *McNamara* and *Johnson*, summarized below, leave no room for doubt regarding the standard of value to be used for professional practices in Michigan divorce settlements.

It is noteworthy that the nonprofessional spouse involved in the *Kowalesky* divorce contended that her husband's dental practice should be valued pursuant to Revenue Ruling 59-60,[10]—which is generally regarded by valuation specialists as setting forth the factors and methodology to be used in determining FMV. In this regard, the court stated as follows:

> *"She invites this court to adopt the valuation method contained in Revenue Ruling 59-60 and apply that method to property divisions in divorce actions. We decline that invitation.*
>
> *"Revenue Ruling 59-60 was promulgated to address the problem of valuing the stock of closely held corporations for estate and gift tax purposes. Defendant urges this court to be the first to apply the ruling to the valuation of professional corporations in divorce actions.*
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> *"We believe that neither Revenue Ruling 59-60 nor any other single method should be uniformly applied in valuing a professional practice. Rather, this court will review the method applied by the trial court, and its application of that method, to determine if the trial court's valuation was clearly erroneous."*[11] (Emphasis added.)

In view of the above, it is clear that the court:

- Clearly rejected the uniform application of the most generally accepted method of determining the sale-based FMV; and
- Added emphasis to the principle that valuation, as with other divorce settlement determinations, should be done on a case specific basis under the principles of equitable distribution.

McNamara

The *McNamara* case involved the value of a law practice in which the trial court stated that it "cannot reasonably place a value on the law practice" and, further, that the law practice had no "readily ascertainable *market value*."[12] (Emphasis added.) Accordingly, the trial court awarded no offsetting value to the wife.

The Court of Appeals rejected the trial court's finding of no value to the husband's law practice, as follows:

> *"Because the trial court did not utilize any method for evaluating the law practice, this court cannot review the trial court's method of evaluation. Therefore, we remand to the trial court for a determination of the value of the law practice. Similar to what transpired in* Kowalesky *there is nothing in the record to support the assumption that the defendant husband will discontinue his law practice. Thus a valuation of the practice should amount to its value to the defendant husband as a going concern* (citation omitted), *and the plaintiff wife should be awarded a one-half interest."*[13] (Emphasis added.)

In short, the court in *McNamara* ruled that the trial court's finding that the practice had no "readily ascertainable *market value*" (read—FMV) was *not* determinative of value for divorce settlement purposes. Rather, on remand, the court issued the specific instruction to determine the practice's value equal to "its *value to the defendant husband as a going concern*" and to award the wife 50% of the value.

Johnson

The most recent of the trilogy, the unpublished 1993 *Johnson* decision involved the value of a medical practice. As the expert who valued the practice on behalf of the plaintiff wife, the author has firsthand knowledge of what transpired at the trial level, which was essentially as follows:

- On behalf of the plaintiff wife, a holder's interest valuation was presented to the trier of fact (a Friend of the Court referee).
- A sale-based measure of value, characterized as the FMV of the practice, was presented by defendant's expert at a value of less than half the holder's interest value.
- Based on the testimony presented, the trier of fact accepted the holder's interest value, resulting in defendant husband's appeal.

The Court of Appeals commented on the disparity between the values as follows:

> *"The chief reason for the difference was that defendant's expert* ***assumed the practice would be sold*** *and utilized a high capitalization rate, while plaintiff's expert used a lower rate on the assumption* ***that defendant would stay with the practice.***"[14] (Emphasis added.)

In upholding the lower court's acceptance of the holder's interest value, determined under the assumption that "defendant would stay with the practice," the court stated as follows:

> "***Where there is no evidence to support an assumption that a business will be sold, the valuation of the business should be its value as a going concern.*** Kowalesky v Kowalesky (citation omitted). *Defendant presented no evidence that he intended to sell the practice; the trial court therefore properly accepted plaintiff's valuation.*"[15] (Emphasis added.)

Thus, the court in *Johnson* ruled essentially as follows:

- First, it noted that the "chief reason" for the difference in values was that one assumed a sale whereas the other assumed that the doctor "would stay with the practice."
- Then, the court noted that no evidence had been presented that the doctor intended to sell the practice.
- Therefore, following the lead of *Kowalesky* and *McNamara*, the court ruled the value of the practice for divorce settlement purposes should be its value to the doctor.

Comments Regarding the Cases

It is submitted that these three Michigan decisions, the only cases to have yet addressed the holder's interest issue, stand squarely behind the principle that:

- For equitable distribution purposes, an interest in a professional practice should be valued based on its value to the owner, assuming the owner will remain in place, absent evidence that the practice will be sold or discontinued; and
- Correspondingly, the nonprofessional spouse should receive an offsetting award of property based on such value.

The same conclusion is expressed by Diana Raimi, author of the "Property Division" chapter of *Michigan Family Law* (Fourth edition), as follows:

> "Kowalesky *supports the proposition that in a divorce, unless there is evidence to the contrary, a business should be valued as if it were going to continue in the hands of its present owner. This implicitly rejects application of discounts for lack of marketability as well as discounts for lack of continuity of management or loss of goodwill.*
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> ***
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> *"A professional practice should be valued at its in-place or going-concern value. This is the value to the owner of the business, assuming that the owner will continue to run the business unless evidence indicates that he or she intends to discontinue the business."*[16]

SUPPORT FROM VALUATION SPECIALISTS

American Bar Association Publication

The American Bar Association, in a joint effort by its Section of Economics of Law Practice and Section of Family Law, published a book entitled *When a Lawyer Divorces: How to Value a Professional Practice, How to Get Extraordinary Remedies,* written by Theodore P. Orenstein and Gary N. Skoloff. Messrs. Orenstein and Skoloff note that, unlike many large commercial enterprises, a professional practice, which depends heavily on the reputation or skill of one or a few professionals, is worth considerably less assuming a sale and the resulting absence of such key people, than assuming they remain with the practice. In support of this position, the authors quote from the opinion of a 1969 California case, *Golden v Golden,* 270 Cal App 2d 401, 75 Cal Rptr 735 (1969), in which the court stated:

> *"The practice of the sole practitioner husband will continue, with the same intangible value as it had during the marriage. Under the principles of community property law, the wife, by virtue of her position of wife, made to that value the same contribution as does a wife to any of the husband's earnings and accumulations during the marriage. She is as much entitled to be recompensed for the contribution as if it were represented by the increased value of stock in a family business."*[17]

The authors also present a cite from *In re Marriage of Lukens,* 16 Wash App 481, 558 P2d 279 (1976), as follows:

> *"Accordingly we do not think the dispositive factor is whether Dr. Lukens can sell his goodwill. His goodwill has value despite its unmarketability, and so long as he maintains his osteopathic practice in Tacoma he will continue to receive a return on the goodwill associated with his name."*[18]

The authors note that the line of cases that follow the principle of value set forth in *Golden* and *Lukens*—such as *Kowalesky, McNamara* and *Johnson* in Michigan—view "goodwill as a presently existing asset from which the professional has been receiving financial benefit during the marriage and from which he will continue to receive financial benefit after the divorce."[19]

American Institute of Certified Public Accountants Sponsored Publications

Alan Zipp, CPA, JD, is a nationally renowned valuation specialist. He was a featured presenter at "The 1990 AICPA National Conference on Divorce" which was sponsored by the American Institute of Certified Public Accountants (AICPA), in conjunction with the American Academy of Matrimonial Lawyers.

Mr. Zipp's presentation was entitled "Divorce Valuation of Businesses and Professional Practices: Valuation Issues and Leading Cases." Included in Mr. Zipp's materials is a section entitled "Divorce Value Is Different From a 'Willing Buyer' Value" which includes his comments regarding "divorce value" vs FMV, as follows:

> *"The basis of value for divorce purposes is not the price a willing buyer would pay for the business.*
>
> ***
>
> *"The basis of value for divorce purposes is the value to the marital community in the*

hands of the current owner. The purpose of the valuation is for equitable distribution, not for sale to a hypothetical 'willing buyer.'

***

"Under the premise of the divorce valuation, there will be no sale of the business to a third party. In a sale, the value to a 'willing buyer' is based on considerations not relevant to continuing operations under the current set of circumstances. The value in the hands of the current owner would ordinarily be different than the value of the business to a 'willing buyer.'

"The purpose of the divorce valuation is to establish a value of the business to the marital community so that a court can equitably divide the marital assets. It is not the purpose of a divorce value to determine the price a willing buyer would pay for the business."[20] (Emphasis added.)

Mr. Zipp also authored the comprehensive *Business Valuation Methods* course materials published by the AICPA in June, 1990. In these materials, Mr. Zipp, while acknowledging FMV as the most widely known measure of value, states that it is not appropriate in all circumstances, as follows:

"In recent years, experts have recognized that the historic test of value, namely the price at which property would change hands between a willing buyer and a willing seller, is not an applicable standard of value in all situations."[21]

With respect to divorce settlements, Mr. Zipp noted that law practices are frequently assigned a value for equitable distribution purposes even though, at the time Mr. Zipp wrote these materials, ethical prohibitions barred the sale of a law practice. With respect to this, Mr. Zipp said as follows:

"Also, in the case of professional businesses, such as a law practice, there may not ever be a willing buyer since ethical rules prohibit the sale of a legal practice. Yet, even though the value under the 'willing buyer' standard might be zero, the divorce court will place a marital property value on the practice as a going concern in relation to its value to the marital community."[22]

RESPONSE TO QUESTIONS *RE:* HOLDER'S INTEREST VALUE

Excessive Values?

One criticism of holder's interest method of valuation is that its application results in excessive values which obstruct efforts to settle divorce cases. Those alleging this, however, generally gauge "excessive" in relation to FMV—that is, what the professional could realize if the practice were to be sold.

The obvious response is simply that, absent evidence that a practice will be sold in the near future, it is quite likely the professional will continue to derive the economic benefits of the practice and, hence, realize the holder's interest value.

One criticism of holder's interest method of valuation is that its application results in excessive values which obstruct efforts to settle divorce cases.

This is not unlike the way in which commercial enterprises are valued for equitable distribution purposes. For instance, consider a manufacturing company, the owner of which has a unique expertise or a valuable personal relationship with a principal customer. In determining a value for the company, the risk of losing the owner, and the corresponding adverse financial effects that would result, are taken into account in selecting the earnings multiple used in the valuation process. Just as Mr. Zipp has indicated in his AICPA materials, it would be improper to further reduce the value of the company for divorce settlement purposes because of effects that would occur if one assumed a sale and the loss of the owner when there is in fact no indication of a sale.

In considering whether holder's interest values are excessive, a review of the holder's interest valuations performed in our office during the last three years revealed that the incremental earnings or goodwill component of value—that is, excluding the "hard" net asset value component—averaged a shade over one times (104%) the professional's average annual net income. Over 10% of the valuations resulted in no incremental earnings value whatsoever. And, for over one-third, the incremental earnings value was less than $100,000. These amounts certainly do not suggest excessive values.

It is noteworthy in this regard that the Court of Appeals in the *Johnson* case stated in rejecting the sale-based FMV value of Dr. Johnson's practice that the value was less than the doctor's "net annual income."[23]

This relationship between the holder's interest's value and the professional's average net income invalidates the allegation that the use of the holder's interest method results in values which frustrate efforts to settle cases. First, professional families often have sufficient other property to offset 50% (or less, depending on the circumstances) of the value of the practice (such as the family residence and, commonly, a relatively large amount in pension or profit sharing funds, if not marketable securities and other assets).

To the extent other assets are not available to fully offset half (or less) of the holder's interest value, the relationship of the professional's income to the holder's interest value of the practice generally enables the professional to pay any remaining balance over a five-year period without undue financial strain.

Can Professionals Realize Holder's Interest Value?

A corresponding concern is that the professional will not be able to realize the holder's interest value by continuing the practice because of the possibilities of death, disability, adverse legislative changes, etc. This risk is taken into account by the use of lower earnings multiples (generally ranging from one to five, with most falling between two and four) than are used in valuing most commercial enterprises.

In addition, many professionals not only continue to reap the financial benefits of their practice during the period they are operating it but also at retirement. This is done by means of a merger, affiliation, or by bringing a younger associate into the practice during a transition period over which the client or patient relationships and referral sources can be effectively transferred to the younger professional on an orderly basis. These techniques by which professionals can "cash in" on their "personal goodwill" from their practices were referred to in a 1990 article by John Stockdale

published in the *Michigan Family Law Journal*. In this regard, Mr. Stockdale said as follows:

> *"...attempts to carry out the transfer of personal goodwill may differ from an outright sale. Common methods include making new partners, merging or affiliating practices or businesses, or hiring highly qualified people and developing their skills and business relationships until they are finally allowed to invest in the practice or business. The compensation for these transfer efforts may come as outright purchase price but is also likely to include periodic payments such as uneven allocation of incremental income to the existing practice partners, retirement payments, or consulting fees after retirement."*[24]

Does Holder's Interest Result in "Double Dipping"?

Another objection periodically raised to the use of the holder's interest method of value is that it results in "double dipping"—that is, the income of the professional is used both to value his or her practice and as a source of alimony.

It should first be noted that the potential for such "double dipping" is not peculiar to the holder's interest method of valuation. Rather, it exists whenever an income-based valuation method is applied to a closely held business enterprise or a professional practice. For all such valuation methods, including holder's interest, a determination of reasonable, or "market value," compensation for the owner is made. "Double dipping" is avoided by limiting the owner's income for purposes of alimony to the amount determined as "reasonable compensation" or the "market value" of services.

For instance, consider a professional who owns his or her practice and averages net income of $175,000 annually. Further, assume that the average annual income of nonowner professionals, performing similar services and with comparable experience, is $125,000. In determining the value of the practice's incremental earnings, only the difference between the owner professional's average income of $175,000 and that of comparable nonowner professionals of $125,000 is capitalized (generally at an earnings multiple ranging from two to four) and incorporated in the value of the practice.

Thus, there is no double dipping of income if alimony is based on the $125,000 "market value" of the professional's services. And, as noted, this is no different when valuing a professional practice according to the holder's interest method than when valuing a commercial company in the many situations where corporate profits are paid out as bonuses to the owners in addition to reasonable compensation for their services.

Extension of Holder's Interest Method to Other Marital Assets

It has also been suggested that the adoption of the holder's interest value or, value to the owner, for professional practices poses the problem that such a standard may be extended to other marital assets. For instance, a particular piece of furniture, painting, set of silver or family picture album may have more value, including sentimental attachment, to one of the parties than the other, and certainly more than its disposition would bring on the market. It has been suggested that this would lead to problems that would make divorce settlements more nettlesome. This concern appears unwarranted for the following reasons:

- First, there is no compelling reason why a standard of value used for one type of marital asset (such as real estate or a closely held business) need be applied to marital assets of a different kind (such as household or personal items).
- Further, the particular value of personal property to an owner is presently taken into account, as it should be, in divorce settlements. For instance, home furnishings are not generally assigned a value at either their replacement cost or what they would fetch at a garage sale. Rather, some value in between is typically used to be fair to the spouse retaining the property as well as to the other who often must replace many of the items remaining with the marital home.
- And, isn't it appropriate that the specific value to the parties involved in a divorce settlement be taken into account in fashioning a divorce settlement? Isn't this the nature of divorce as a matter in equity, that is, to take the value property has had to the parties while married and divide that same value as equitably as possible to them incident to their divorce?
- Finally, in most cases, divorcing spouses informally agree on a split of personal property, unfettered by concerns of whether the standard of value they intuitively apply is the same used to value a marital home or family business.

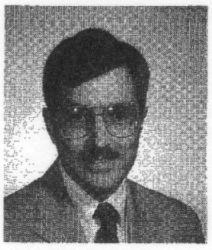
CONCLUDING COMMENTS

In valuing property for equitable distribution purposes, Michigan courts have consistently rejected the arbitrary use of any one standard of value or method of valuation. As noted, the Court of Appeals said in its *Heike* opinion when rejecting the arbitrary use of the early retirement age assumption for valuing pensions:

> *"The trial court is in the best position to determine the proper date and method of valuation based on the circumstances of each case.* (Citation omitted.) *We therefore hold that no one valuation method is required, but rather the trial court ... is obligated to reach a fair and equitable division of the property in light of all of the circumstances."* (Emphasis added.)

Pursuant to the same case specific approach to valuation, as noted above, the court in *Kowalesky* rejected "the invitation" to adopt the uniform application of FMV according to Revenue Ruling 59-60. This case specific approach to valuation, embraced by Michigan courts and nationally renowned divorce valuation specialists, is aimed at establishing the value that property has had to the marital community.

Use of the holder's interest method of valuation has the same end—that is, to



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determine the value of a professional practice based on the economic benefits it has provided to the family unit and will continue to provide to the owner-professional after the divorce absent a sale. If there is an indication a sale will occur, then FMV is the relevant standard of value under the case specific approach which takes into account the circumstances of the parties.

Questions periodically raised concerning the use of the holder's interest value generally result from either a lack of understanding of the equitable, case specific premise on which this method is based or a belief that FMV is the appropriate standard of value to use across the board for divorce settlement purposes—a view soundly rejected by Michigan courts.

In fact, the appropriate determination and use of holder's interest value will not result in excessive values, "double dipping" or in an amount that the professional is not likely to realize. Rather, it is an amount which represents the value to the marital community—which Michigan courts have found to be the relevant value for purposes of fashioning a division of marital property in a way that is fair and equitable to both parties.

Whether this measure of value is referred to as "holder's interest," "ownership," "value in use," or some other similar term—or, FMV, in situations where a practice is to be sold, is of little significance. What is important is that, as Michigan courts have consistently ruled, the method applied is "case specific," designed to establish a value to the particular parties of the divorce, taking their circumstances appropriately into account. ■

Footnotes

1. Orville B. Lefko, "The Holder's Interest Valuation Defined, Discussed and Expanded (*Kowalesky v Kowalesky* Revisited)," 71 Mich. B.J. 293 (1992); John J. Stockdale, "Holder's Interest Valuation—*Kowalesky* Revisionism," 72 Mich. B.J. 702 (1993).
2. Treasury Regs. 25.2512-1.
3. *Kilbride v Kilbride*, 172 Mich App 421 (1988).
4. William A. Troyan, "Pension Valuation and Equitable Distribution," *The Family Law Reporter Monograph No. 2*, Volume 10, No. 4 (Washington, D.C.: The Bureau of National Affairs), pp. 3001-3016.
5. *Heike v Heike*, 198 Mich App 293 (1993).
6. *Kowalesky v Kowalesky*, 148 Mich App 151 (1986).
7. *McNamara v McNamara*, 178 Mich App 382 (1989).
8. *Johnson v Johnson*, Mich App No. 132388, 3/24/93.
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10. Rev. Rul. 59-60, 1959-1, C.B. 237.
11. *Kowalesky, supra* at 154-156.
12. *McNamara, supra* at 392.
13. *McNamara, supra* at 393.
14. *Johnson, supra.*
15. *Johnson, supra.*
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17. Orenstein and Skoloff, p. 9.
18. Orenstein and Skoloff, p. 10.
19. Orenstein and Skoloff, p. 10.
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21. Alan S. Zipp, CPA, JD, *Business Valuation Methods*, 1990, pp. 1-11.
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23. *Johnson, supra.*
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