Value to the Owner Cuts Both Ways

By Joseph W. Cunningham, JD, CPA

It was recently asserted in a case that if a business could be sold for more than it is worth to the owner, then the higher sale value should be used for divorce settlement purposes.

This case involved a minority shareholder who had no authority to sell the business, and the shareholders holding a majority interest had no intention of selling the company.

As recently summarized this column (October 2016), the Michigan Court of Appeals has ruled in a number of cases that if a business providing personal services is worth more to the owner than the price at which it could be sold, the value for divorce purposes is value to the owner – sometimes called "holder's interest value" – unless there is reason to believe the enterprise will be sold.

But what about the reverse situation – the sale value – that is, fair market value (FMV) – is higher than the value to the owner?

Premise of Value to Owner

If there is no intent to sell or discontinue a business or professional practice, it should be valued for divorce based on its intrinsic value to the owner on a going concern basis. The financial benefits from *that value* are what have been conferred on the family while intact and will be conferred solely on the owner post-divorce.

Support – *Kowalesky,* 148 Mich App 151 (1986) and several other Court of Appeals (COA) cases (see October 2016 Tax Trends column).

Logic – If there is no intent to sell, under what rationale should any value other than the value based on current financial benefits provided by the business be used in a divorce settlement?

No other value is relevant to this family or, hence, to this divorce.

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Value to Owner Higher than FMV - The value of a neurosurgeon's practice – dependent solely on established referral sources to this particular doctor – is worth much more assuming the doctor will continue the practice than to sell it. According to the COA, the higher value applies in divorce if there is no reason to believe the practice will be sold.

FMV Higher than Value to Owner – A few years ago consolidators were "rolling up" funeral homes to add value via economies of scale – synergistic value. But, if a family-owned funeral home intended to remain as such and had no intention of "going corporate," would it make any sense to use the higher potential sale value which is, essentially, irrelevant to this family, this divorce?

Logic – What possibly supports applying value to owner if higher, but not if lower? Either way, should not the value to this particular family be used?

Clawback Provision

If potential sale value is significantly higher than value to owner, the non-owner can be protected by use of a clawback provision which provides that in the event of sale within a certain time frame, the non-owner will receive some percentage of net sale proceeds in excess of the value used in the divorce.

Depending on the circumstances, a declining percentage may be appropriate – e.g. 50% of the excess if the sale occurs within a year of divorce, 40% within two years, and so on.

Such a provision should be considered particularly if there is reason to believe a sale may occur in the near term.

It is not a failsafe method for safeguarding the non-owner, but does afford some measure of protection.

About the Author

__Joe Cunningham__ has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy, though his practice is statewide.