Winter 2017

Valuation Verdicts®

Current Valuation & Taxation Rulings Regarding Divorce

Barrett Valuation Services, Inc.
989 Reservoir Avenue, Cranston R.I. 02910
Tel: (401) 942-3900 • Fax: (401) 942-3988
email: info@BarrettValuation.com
www.BarrettValuation.com

John E. Barrett, Jr., CPA
Accredited in Business Valuation
Certified Business Appraiser
Certified Valuation Analyst

Divided Court Addresses Issue of Appreciation of Gifted Property

In re Marriage of Kerkhoff, 2016 Iowa App. LEXIS 905 (Aug. 31, 2016). A recent Iowa divorce case turned on the question of how to deal with the appreciation of separate gifted property. This is a "troublesome issue" in that different states have adopted different analytical frameworks and as a result produced "chaotic and inconsistent" results, the dissenting judge in the case wrote. Even though the majority opinion does little to bring clarity to the issue, the case is noteworthy for the dissent's proposition of a more streamlined analysis that could lead to a more equitable outcome.

The husband owned a minority interest in a series of business entities that were under the complete control of his father, an accomplished businessman. The husband and the wife were co-owners of one of the corporations, which built and ran senior living centers. The husband administered the centers. He was paid a very low salary but received management fees and distributions at the discretion of the father. The wife had at times performed tasks in the facilities but overall was not involved in corporate affairs. She mostly took care of the family.

Prior to and during the marriage, the husband's father gave stock in the corporations to the husband and other children. He testified that he did not intend to make gifts to the children's spouses.

At the time of divorce, the couple had been married for over 20 years. The gifted stock had appreciated by almost $5 million. The wife did not claim a right to the gifted stock, but she asked the trial court to award her half of the appreciated amount.

The trial court rejected the request. The trial court's analysis focused exclusively on the issue of whether the wife had a right to the gifted stock, as opposed to the appreciation in the value of that stock.

Among other things, the trial court explained its rejection of an award by noting the donor's intent and the wife's failure to contribute to the care, preservation, or improvement of the gifted property. The gifted corporate stock provided "minimal support" to the parties during the marriage, the court decided. Its "real" value was "the establishment of a standard of living for the parties." In terms of an equitable distribution, the gifted stock was "primarily relevant" to determining spousal support, the court said.

The wife unsuccessfully appealed the ruling at the state Court of Appeals. Just as the trial court, the majority of the appeals court focused its analysis on the legal principles in play when determining whether gifted or inherited property should be subject to division. Under the applicable law, a division is permissible "upon a finding that refusal to divide the property is inequitable to the other party or to the children of the marriage," the court noted.

To rule on the equity/fairness question, state courts have considered a number of factors including what contributions the parties made to the property and whether there was an a "independent close" relationship between the donor and the spouse of the donee. Courts also may consider the length of the marriage.

The trial court undertook the proper analysis, the majority concluded.

The majority's and trial court's conclusion sparked a strong dissent from the chief judge of the Court of Appeals. He said he believed the outcome was contrary to case law, the principles underlying the applicable statute, and inequitable.

The dissent thought it "significant to realize" the dispute was not over the original gift, but over the appreciation of the gifted corporate stock. The wife only wanted a share of the appreciation that arose during the marriage, the dissent pointed out.

Relying on case law dealing specifically with the issue of how to handle the appreciated value of assets, including separately held assets, the dissent found in a long-term marriage there should be a division of the appreciated value as long as neither party "shirked their duties." Focusing on the fact that both parties contributed to the marriage rather than the parties' specific tasks was not only equitable, but also a way to

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avoid the difficulties of having to weigh the parties' contributions, the dissent found.

In this case, the appreciation of stock should be divided equally, the dissent concluded.

Court Digs Through Appreciation Issues in Complex Divorce Case

***In Kminek-Nierenberg v. Kenneth Nierenberg,* 2016 NJ Super. Unpub. LEXIS 2015 (Sept. 8, 2016).** A complex New Jersey divorce litigation with multiple defendants and several family businesses illustrated the challenges appraisers and the trial court faced in determining the appreciated value of numerous separate premarital and gifted assets for equitable distribution purposes. The case highlights basic principles related to the status of an asset.

Before the marriage, the husband and his parents established four corporations involved in operating Princeton Airport in New Jersey. Initially, all three partners each held a one-third interest in the companies. Several years into the marriage, the husband's parents executed an estate plan under which each parent gifted his and her one-third ownership interest in three of the companies to the husband, making him the sole owner of those corporations.

However, the parents maintained their combined two-third ownership in one company. In connection with the transfers, the parties also executed a new shareholder agreement that required shares in the parent-controlled company to be sold back for "book value" in the event of the death, divorce, or bankruptcy of a shareholder.

The husband and wife married in 1992 and separated in summer 2003. The wife filed for divorce in early 2005. In 2007, the parents invoked the "divorce provision" requiring the husband to sell his shares back to the parent-controlled company for book value.

One of the contested companies had engaged in a "like-kind" exchanged under Section 1031 of the Internal Revenue Code. To enable the transaction, the husband and his parents had used some personal funds. Besides the funding, the husband apparently had no meaningful role in managing and arranging for the sale of the exchanged property.

The divorce trial took place in 2012 and 2013. The wife subsequently challenged most of the trial court's rulings with the New Jersey Superior Court, Appellate Division.

Among other things, the wife contended the estate plan, especially the new shareholder agreement and its buyback provision, was an attempt to defraud her of her equitable distribution.

The trial court found, and the appellate division affirmed, the wife had failed to show the parents knew of any marital difficulties when they made the plan. The applicable statute allowed for "reasonable restrictions on the transfer of shares."

The wife also claimed that a loan to the husband to buy his interest in one of the corporations had become commingled with marital funds, which exposed the asset to equitable distribution.

The trial court disagreed, noting the loan was a premarital event, and the husband's interest in the company remained his separate property. Moreover, the asset was passive - "any value fluctuations were based exclusively on market conditions." The court noted the husband's role in the Section 1031 exchange related to this asset and the exchanged property was "minimal and passive."

However, because the husband used marital funds to affect the Section 1031 exchange, the wife was entitled to half of that amount. The court's appellate division upheld all of these findings.

The trial court decided that a second company was an active asset for equitable distribution purposes. The wife, it said, was entitled to the company's appreciation in value from 1992, when the parties were married, to 2000, when the company was gifted to the husband by his parents, then to 2005, when the wife filed for divorce.

Under the applicable case law, an "active immune asset involves contributions and efforts by one or both spouses toward the asset's growth and development which directly increase its value." If the increase is the result of the owner spouse alone, it is not subject to distribution. But, "to the extent that it may be attributable to the expenditures or the efforts of the non-owner spouse...a determination must be made regarding the extent the original investment has been enhanced by contributions of either spouse."

The appellate division concluded the valuation methodology the trial court used was within its discretion.

In terms of a third asset, the trial court found the wife had a right to one-sixth of the appreciation during the marriage, The percentage reflected one-half of the husband's one-third premarital interest.

The appellate panel agreed and found the trial court had carefully evaluated the valuation evidence to arrive at a fair value for its appreciation.

One major unresolved issue in the appeal was the status of an investment account. The trial court found the husband's father was the sole owner. Therefore, the asset was exempt from equitable distribution.

The appellate panel disagreed, noting the account held funds from various parties. The account was not gifted as part of the estate plan, and it did not appear to be funded solely by corporate monies. Therefore, the appellate division remanded for a determination of the ownership of the account and a review of the effects on the valuations and equitable distribution findings.

Court Addresses Whether Husband Dissipated Assets

In re Marriage of Schneeweis, 2016, IL App (2d) 140147. There the Appellate Court affirmed the Trial Court's ruling that husband dissipated much of the marital estate by using marital funds to engage in high-risk securities trading, without telling his wife any details. However, this occurred several years before wife ultimately filed for divorce. This decision could cause many litigants problems, given the fact that most married couples, even while happily married, do not fully communicate with respect to their finances.

Dissipation is one of the factors that a Trial Court must consider in allocating marital property equitably. Dissipation is defined as the "use of marital property for the sole benefit of one of the spouses for a purpose unrelated to the marriage at a time that the marriage is undergoing an irreconcilable breakdown."

In this case, husband worked during most of the marriage in sales and management positions and not in any way in investment services, despite obtaining a license to trade just after college. Husband paid most of the bills and made all of the parties' investment decisions throughout the marriage. The parties were married in 1993 and in November 2009, wife filed for divorce. The Trial Court found that the marriage began undergoing an irreconcilable breakdown in June 2005 and curiously, husband did not contest this finding on appeal which could have mitigated the amount of dissipation.

In July 2005, the parties refinanced their home and husband opened a Home Equity Line of Credit (HELOC) in his own name without wife's knowledge. He also opened a savings account without wife's knowledge and transferred monies drawn on the HELOC into that account. In 2005, the parties' investments were managed by reputable third-party institutions. In late 2005, husband told wife that he wanted to quit work. Wife told him that he should not quit his job until he found a new job. In January 2006, husband exercised certain stock options and transferred monies into a newly opened account without informing his wife. In October 2006, husband quit his job and planned to begin trading securities in his own account in order to provide for the family. He told wife of his actions and intentions later the same day he quit.

Thereafter, husband began making day trades. Wife testified that she did not know what husband was doing when he said he was "trading" and he kept her out of their home office where he worked. He never discussed with wife the extent of any losses incurred through his day trading. In early 2007, husband enrolled in a two-year program of online courses from a company called Investools, and he spent hours on the telephone discussing potential investment strategies with personal trading coaches. He completed the two-year program.

In mid-2007, husband transferred over one million dollars of the parties' personal assets, including almost $400,000 from his retirement account into his trading account. From June 2007 through August 2008, husband continued high-risk trading, funding his trades through increasing margin debt. The Stock Market then declined and in late 2008, there was less than $200,000 left.

The Trial Court issued its Judgment on January 8, 2013, and found that husband dissipated over $890,000. Specifically, the Trial Court found that husband "commenced in the course of speculative, high-risk investing without the necessary acumen and experience." The Trial Court further found that husband dissipated marital assets "in that he caused or allowed the devaluation of the marital estate through his unwise trading practices and his incurring of significant debt without his wife's knowledge."

On appeal husband argued that while he failed to discuss his trading activities with wife, his course of conduct did not amount to dissipation because he did not

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intend to lose money; rather, he was simply caught in a stock market crash.

The Appellate Court rejected this argument based, in part, on the fact that intent is only one factor that the Court may consider when determining dissipation and since intent was not dispositive in finding dissipation, even if his intent was to make a profit, his actions could still constitute dissipation. The Court further diluted the importance of intent by noting the definition of dissipation does not include any reference to the dissipating spouse's intent and also noting that gambling with marital funds historically has been treated as dissipation, despite the fact that the gamblers intended to win.

The Court then distinguished a Fourth District decision that found a husband's losses from commodities trading did not constitute dissipation because there was no evidence of intent to willfully dissipate marital assets since the investments were made prior to and in the early part of the marriage when there is no indication of marital discord.

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John E. Barrett, Jr., CPA/ABV, CBA, CVA
Barrett Valuation Services, Inc.
989 Reservoir Avenue
Cranston, RI 0910
Phone: (401) 942-3900
Fax: (401) 942-3988
Email: info@BarrettValuation.com
www.BarrettValuation.com

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Barrett Valuation Services, Inc.
The Business Valuation Advisors
989 Reservoir Avenue
Cranston, RI 02910