

# **Analysis of case law dealing with the valuation of a professional practice in a family law action, including good will**

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## 1. Introduction

The valuation of a professional practice is one of the most expensive tasks in a marital dissolution action. The spouse who operates the practice will soon realize that the methods used for valuing his or her practice have little to do with the fair market value of the practice, and will rightfully complain that a willing buyer might not even exist. Concerns about "double-dipping" also exist when the same earnings which are used to find a value in the practice are also used for calculating support. Still, if there is a value to the practice based on marital efforts, it has to be divided.

Several cases in California have reviewed the methods used by experts in valuing a professional practice. One thing which is consistent between all of these decisions is that the court will uphold any method for valuing the practice, including goodwill, so long as the evidence legitimately establishes value.

## 2. General Principles

When valuing a professional practice, a trial court should determine the existence and value of the following:

(a) fixed assets, which we deem to include cash, furniture, equipment, supplies and law library; (b) other assets, including properly aged accounts receivable, costs advanced with due regard for their collectability, work in progress partially completed but not billed as a receivable, and work completed but not billed; (c) goodwill of the practitioner in his law business as a going concern; and (d) liabilities of the practitioner related to his business.

(In re Marriage of Lopez (1974) 38 Cal. App. 3d 93, 110, disapproved on other grounds, In re Marriage of Morrison (1978) 20 Cal.3d 437, 453.)

The factors listed in IRS Revenue Ruling 59-60 should also be used to evaluate closely held stock, “[u]nless there is some statutory or decisional proscription on their use.” (In re Marriage of Hewitson (1983) 142 Cal.App.3d 874, 888.) These factors are:

- (a) The nature of the business and the history of the enterprise from its inception.
  - (b) The economic outlook in general and the condition and outlook of the specific industry in particular.
  - (c) The book value of the stock and the financial condition of the business.
  - (d) The earning capacity of the company.
  - (e) The dividend paying capacity.
  - (f) Whether or not the enterprise has goodwill or other intangible value.
  - (g) Sales of stock and the size of the block of stock to be valued.
  - (h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.
- (Id. at p. 883, fn. 9, quoting IRS Revenue Ruling 59-60 .)

However, the use of factor (h) of Revenue Ruling 59-60, which involves a comparison to a publicly traded company, has been criticized. Specifically, it has been found improper to compare the price-earnings of a publicly traded corporation to a close corporation as the exclusive means to value the later. (In re Marriage of Lotz (1981) 120 Cal.App.3d 379, 384.)

### 3. The Standard of Value

Except when assets are divided in kind, the court is obligated to rule upon the value of the assets and divide them equally between the parties. (See Fam. Code, §§ 2550 & 2552; In re Marriage of Cream (1993) 13 Cal.App.4th 81.) The proper standard to use in valuing the marital assets has been subject to considerable debate, fueled by the court’s imprecise use of terms such as “going concern value”, “investment value”, or worse: “value”.

Fair market value is defined by the United States Treasury Regulations as ‘the price at which the 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. [Citations.] This

definition is generally accepted in California."

(In re Marriage of Hewitson (1983) 142 Cal.App.3d 874, 882, fn. 8; see also In re Marriage of Cream (1993) 13 Cal.App.4th 81, 89 (same definition without the "reasonable knowledge of relevant facts" element.)

The fair market value standard has been restricted to marketable assets. (In re Marriage of Cream (1993) 13 Cal.App.4th 81, 89. In Cream, the court overruled an order requiring the use of an interspousal auction to dispose of a privately owned geyser where the husband had asked that it be awarded to him at more than its fair market value. The court stated: "We restrict the use of [the fair market value standard] to marketable assets because some marital assets are not marketable, but nonetheless may have to be valued." (Id.) The court in Cream did not specify what method should be used to value an unmarketable asset, but an answer might be found in Code of Civil Procedure section 1263.320, subdivision (b), relating to eminent domain: The fair market value of property taken for which there is no relevant market is its value on the date of valuation as determined by any method of valuation that is just and equitable.

Recognizing the problems inherent in valuing goodwill, the court in the case of In re Marriage of Lopez issued the following warning:

While 'market value' and the value for marital dissolution purposes of 'professional goodwill' may be synonymous, in our view such value should be determined with considerable care and caution, since it is a unique situation in which the continuing practitioner is judicially forced to buy an intangible asset at a judicially determined value and compelled to pay a former spouse her share in tangible assets. (Civ. Code, §4800.)

(In re Marriage of Lopez (1974) 38 Cal. App. 3d 93, 110 (italics in original), disapproved on other grounds, In re Marriage of Morrison (1978) 20 Cal.3d 437, 453.)

Lopez moved away from the fair market value standard and toward one based on intrinsic value. This is evident by the court's statement that factors such as the practitioner's age and health should be used in valuing professional goodwill, which may be more relevant to the owner-spouse than to a hypothetical buyer of goodwill on the open market. (See below, "Valuation Methodology in General".)

The standard of value in a goodwill case was also addressed in the case of *In re Marriage of Foster*, where the court stated:

The value of community goodwill is not necessarily the specified amount of money that a willing buyer would pay for such goodwill. In view of the exigencies that are ordinarily attendant a marriage dissolution the amount obtainable in the marketplace might well be less than the true value of the goodwill. Community goodwill is a portion of the community value of the professional practice as a going concern on the date of the dissolution of the marriage.

(*In re Marriage of Foster* (1974) 42 Cal.App.3d 577, 584.)

The *Foster* court correctly notes that a sale of goodwill during a divorce might command less than its "true value" because of the pressures involved in a divorce. However, if a fair market value approach is used, this concern is moot because the definition of "fair market value" assumes that the hypothetical buyer and seller are not under any compulsion to buy or sell. It appears that the court was just trying to say that the community interest in the goodwill cannot be valued as if the practice were being liquidated.

#### 4. Date of Valuation

The general rule under California law is that assets and liabilities are to be valued as of the date of trial. (Fam. Code, § 2552, subd. (a).) Professional practices, however, will typically be valued as of the date of separation (*In re Marriage of Duncan* (2001) 90 Cal.App.4th 617, 625), or more technically on the day after the date of separation (see Fam. Code, § 2552, subd. (b) ("the court for good cause shown may value all or any portion of the assets and liabilities at a date after separation and before trial to accomplish an equal division of the community estate of the parties in an equitable manner.)) The reason for the rule is that post-separation earnings are the separate property of the spouse who earned the money. (Fam. Code, § 771.)

#### 5. Goodwill

##### a. Definition of "Goodwill"

"The 'good will' of a business is the expectation of continued public patronage." (Cal. Bus. & Prof. Code, § 14100.) Goodwill has also been defined by cases as:

'the advantage or benefit which is acquired by an establishment beyond the mere value of the capital stock, funds or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances, or necessities, or even from ancient partialities or prejudices. [Citation.] . . . it is the probability that the old customers will resort to the old place. It is the probability that the business will continue in the future as in the past, adding to the profits of the concern and contributing to the means of meeting its engagements as they come in.' [Citations.]

(In re Marriage of Foster (1974) 42 Cal.App.3d 577, 581.)

"The trier of fact may take into consideration the situation of the business premises, the amount of patronage, the personality of the parties engaged in the business, the length of time the business has been established, and the habit of its customers in continuing to patronize the business. The court may also take into consideration the market value at which the business goodwill could be sold on dissolution of the marriage." (In re Marriage of Webb (1979) 94 Cal.App.3d 335, 344.)

A spouse may have personal goodwill in addition to a share of any goodwill belonging to a partnership or corporation in which the spouse has an interest. (See In re Marriage of Iredale (2004) 121 Cal.App.4th 321 (experts valued goodwill of a law firm partner based on a personal and a partnership level).

#### b. Valuation Methodology in General

"Goodwill value may be measured by 'any legitimate method of evaluation that measures its present value by taking into account some past result,' so long as the evidence 'legitimately establishes value.' [Citation omitted.] " (In re Marriage

of Rosen (2002) 105 Cal.App.4th 808, 819.)

Certain matters merit consideration which may be said reasonably to contribute to, diminish, or affect the intangible value of professional goodwill at the time of dissolution and the continuity and retention of the benefits thereof which the professional practitioner will continue to enjoy after the marital dissolution. In that context some such factors are the practitioner's age, health, past demonstrated earning power, professional reputation in the community as to his judgment, skill, knowledge, his comparative professional success, and the nature and duration of his business as a sole practitioner or as a member of a partnership or professional corporation to which his professional efforts have made a proprietary contribution. In addition, consideration should be given to the value of the 'fixed' and 'other assets' of the professional business with which the 'goodwill' is to continue its relationship.

(In re Marriage of Lopez (1974) 38 Cal. App. 3d 93, 109-110, disapproved on other grounds, In re Marriage of Morrison (1978) 20 Cal.3d 437, 453.)

#### c. Pre-Marital and Post-Marital Efforts Excluded

A professional spouse's income after the date of separation is irrelevant for valuing goodwill belonging to the community. (See In re Marriage of Rosen (2002) 105 Cal.App.4th 808, 821.) Stated another way, "community goodwill may be evaluated by no method that is dependent upon the post-marital efforts of either spouse." (In re Marriage of Fortier (1973) 34 Cal.App.3d 384, 387.) The reason is that a spouse's earnings after the date of separation are his or her own separate property. (Cal. Fam. Code, § 771.)

Likewise, any pre-marital acquisition of goodwill should be excluded when valuing the community interest in the practice. (See In re Marriage of Rives (1982) 130 Cal.App.3d 138, 150 ("husband's skill, experience and reputation ... were acquired in the 40 years prior to the relatively short marriage and thus cannot be considered to have been acquired by operation of the business as a community asset."))

#### d. Indicia of Ownership Requirement

A preliminary requirement for goodwill to exist is that the spouse have some ownership interest in the business for which he or she provides services.

(See *In re Marriage of Slivka* (1986) 183 Cal.App.3d 159.) In *Slivka*, the husband was a radiologist for four years. For the last two years, he was a partner in a medical group, which in turn had a contract with a health maintenance organization (Kaiser) to provide medical services to the HMO's members. (Id. at p. 163.) The husband made no capital contribution to the medical group on becoming a partner, will receive no payment on his departure, and cannot sell his partnership interest. The medical group's only contract is with Kaiser; there is no other patient base. The husband's compensation consists of a base salary, overtime, and bonuses. The court observed that the husband "is most similar to an employee who has no ownership interest and is paid for services rendered." (Id. at p. 164.) Based on these facts, the court of appeal held that there was substantial evidence to support the trial court's ruling that the husband had no goodwill of any demonstrable value. (Id. at pp. 163-164.)

#### e. The Excess Earnings Method

The most often used approach recognized by California courts in establishing goodwill is the excess earnings method.

Pursuant to [the excess earnings] method, one first determines a practitioner's average annual net earnings (before income taxes) by reference to any period that seems reasonably illustrative of the current rate of earnings. One then determines the annual salary of a typical salaried employee who has had experience commensurate with the spouse who is the sole practitioner or sole owner/employee. Next, one deducts from the average net pretax earnings of the business or practice a 'fair return' on the net tangible assets used by the business. Then, one determines the 'excess earnings' by subtracting the annual salary of the average salaried person from the average net pretax earnings of the business or practice remaining after deducting a fair return on tangible assets. Finally, one capitalizes the excess earnings over a period of years by multiplying it by a factor equal to a specific period of years, discounted to reflect present value of the excess earnings over that period. The period varies according to factors such as the type of business, its stability, and its earnings trend.

(*In re Marriage of Garrity & Bishton* (1986) 181 Cal.App.3d 675, 688, fn. 14.)

#### i. The "Average Salaried Person" and the "Similarly Situated Professional"

## Standards

The Garrity & Bishton case used the “average salaried person” standard for determining the goodwill of a law practice. This standard compares the subject spouse’s average annual net pretax earnings to “a typical salaried employee who has had experience commensurate with the [subject] spouse”). (In re Marriage of Garrity & Bishton, *supra*, 181 Cal.App.3d at p. 688, fn. 14.)

More recent decisions, however, have used a “similarly situated professional” standard. (See In re Marriage of Iredale (2004) 121 Cal.App.4th 321; In re Marriage of Rosen (2002) 105 Cal.App.4th 808, 823.) Under this standard, reasonable compensation is based upon “the cost of hiring a nonowner outsider to perform the same average amount that other people are normally compensated for performing similar services.” (In re Marriage of Iredale, *supra*, 121 Cal.App.4th 321, quoting In re Marriage of Rosen, *supra*, 105 Cal.App.4th at p. 823.) The intent is to take into account all of the services that the spouses contributes to the professional practice. For example, the cost of hiring an employee to perform the daily functions of the owner would not always be the true replacement cost of the owner. In most cases, the owner is responsible for bringing business to the firm and shaping the direction of the practice. The value of these non-billable services must be included when determining the salary which would be required to attract a replacement for the owner.

In Iredale, one of the issues was whether it was proper for the trial court to use the “similarly situated professional” standard instead of the “average salaried person” in valuing a wife’s partnership interest in a large law firm. The court of appeal held that

... the method of comparing [the wife’s] compensation to what it would cost to hire an associate (actually 1.4 associates) did not account for the nonbillable hours expended by [her], nor would an associate be likely to have a client base comparable to [hers]. Comparing [the wife’s] compensation to that of similarly situated professionals, rather than to a salaried employee, was indeed a more rational and reasonable method by which to calculate the value of [her] goodwill in this case. (In re Marriage of Iredale, *supra*, 121 Cal.App.4th 321.)



## ii. Use of Compensation Surveys

If an expert relies on a survey to find reasonable compensation, the survey must be statistically valid and relevant to the practice being valued. (In re Marriage of Rosen (2002) 105 Cal.App.4th 808.) The Rosen case involved the valuation of the husband's solo law practice in southern California who handled state-appointed criminal appeals. The wife's expert took the average of two national compensation surveys to find that the reasonable compensation to hire an attorney to replace the husband was \$100,000. The court of appeal found that the expert's opinion was inadmissible, stating:

[The wife's] expert testified he did not have any particular knowledge of lawyer compensation, other than what he had learned from valuations he had performed. He admitted he was not familiar with a law practice like [the husband's]. He did not conduct a survey or perform any kind of study of lawyer compensation in Southern California. Rather, he relied entirely upon two surveys of compensation (the Altman Weil survey and the Robert Morris survey), neither of which dealt with a sole practitioner lawyer handling state-funded criminal appeals. The expert did not attempt to relate the information in the surveys to an analysis of [the husband's] law practice.

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[The wife's] expert might just as well have plucked the \$100,000 figure from thin air. We do not disapprove of compensation surveys as a general matter. We realize they can be useful when used properly. But we question whether a national survey of lawyer compensation (such as the Altman Weil survey) is a proper basis for offering an opinion on average lawyer compensation in Southern California. (See Evid. Code, §801, subd. (b).) We also question whether the Altman Weil survey is applicable to [the husband's] law practice, which consists almost exclusively of handling state-funded criminal appeals. The expert though did not hold himself to the compensation figures in the Altman Weil survey, but turned to another survey—the Robert Morris survey—purporting to show average compensation for officers and directors of various kinds of businesses. We believe the Robert Morris survey is inapplicable to a sole practitioner lawyer, such as [the husband], who does not have officers or directors. [The wife's] expert then used his own 'judgment' to come up with a compensation figure based upon the numbers in these two surveys, even though he admitted he did not have any

particular knowledge about lawyer compensation and did not know of any attorney with a law practice like [the husband's]. In essence, [the wife's] expert did nothing more than pick \$100,000 because it was about halfway between \$125,000 and \$67,000. Those two numbers bear no particular materiality to the issue of reasonable compensation in this case. (Id. at p. 822.)

The use of informal surveys by an expert in forming an opinion has also been criticized as being based upon unreliable hearsay. (*Korsak v. Atlas Hotels, Inc.* (1992) 2 Cal.App.4th 1516.) Before an expert may rely upon hearsay in forming an opinion, it must be shown that the hearsay information is of a type that may reasonably be relied upon by professionals in the field in forming an opinion on the subject. (Id. at p. 1524; Cal. Evid. Code, § 801, subd. (b).)

In *Korsak*, a mechanical engineering expert contacted several unnamed hotel workers about their usual plumbing practices as the basis for his opinion that the opposing party was negligent in failing to perform certain maintenance at its hotel. There was no showing that the survey was scientifically conducted, that the information received was reliable, or that it was of a type normally relied upon by engineers in forming expert opinions. In holding that the expert's testimony was inadmissible, the court of appeal stated:

... it does not appear that the information [the expert] presented resulted from any form of scientific study, survey, or investigation. We do not doubt there may be cases in which a qualified researcher could conduct a survey of some relevant form of activity and reliably report such results to a trier of fact or to another expert. [Citation omitted.] Nothing in this record, however, suggests the expert relied upon any scientific sampling of the hotel industry. Rather, he made an unexplained, casual sampling of unknown sources within the 'hotel business.' The authenticity, reliability, or the representative nature of the responses are totally undeterminable based upon [the expert's] testimony. (*Korsak*, supra, 2 Cal.App.4th at 1526.)

iii. Past Earnings

Excess earnings must be based on “a practitioner’s average annual net earnings (before income taxes) by reference to any period that seems reasonably illustrative of the current rate of earnings.” (In re Marriage of Rosen, *supra*, 105 Cal.App.4th at p. 820, quoting In re Marriage of Garrity & Bishton (1986) 181 Cal.App.3d 675.) “The past earnings to which the [excess earnings] formula is applied should fairly reflect the probable future earnings. Ordinarily, the period should not be less than five years, and abnormal years, whether above or below the average, should be eliminated...” (Rev. Rul. 68-609 (1967-1 Cum. Bul. 576).) It should also be kept in mind, however, that:

Prior earnings records usually are the most reliable guide as to the future expectancy, but resort to arbitrary five-or-ten year averages without regard to current trends or future prospects will not produce a realistic valuation. If for instance, a record of progressively increasing or decreasing net income is found, then greater weight may be accorded the most recent years' profits in estimating earning power....  
(Rev. Rul. 59-60 (1959-1 Cum. Bul. 237, 241).)

Both of the Revenue Rulings quoted above refer to using past earnings as a guide for “future expectancy” of earnings or “probable future earnings”. This is at odds with the requirement that post separation (i.e., future) earnings be excluded when valuing goodwill.  
(See “Pre-Marital and Post-Marital Efforts Excluded”.) The better approach, at least when applied to a California marital dissolution case, would be to say that a reasonable period of past earnings must be selected in order to determine the “current rate of earnings” – not to predict what the future earnings will be. (See In re Marriage of Rosen, *supra*, 105 Cal.App.4th at p. 820.) This was the view offered by the court in the case of In re Marriage of Lopez:

We think it follows that in marital cases the expectancy of future earnings is not synonymous with, nor should it be the basis for, determining the value of “goodwill” of a professional practice, but is simply a factor to consider in deciding if such an asset exists.  
(In re Marriage of Lopez (1974) 38 Cal. App. 3d 93, 108-109 (italics removed), disapproved on other grounds, In re Marriage of Morrison (1978) 20 Cal.3d 437, 453.)

#### iv. Capitalization Rate

A determination of the proper capitalization rate presents one of the most difficult problems in valuation.... Thus, no standard tables of capitalization rates applicable to closely held corporations can be formulated. Among the more important factors to be taken into consideration in deciding upon a capitalization rate in a particular case are: (1) the nature of the business; (2) the risk involved; and (3) the stability or irregularity of earnings. (Rev. Rul. 59-60, §6 (1959-1 Cum. Bul. 237).) This rule applies to “problems involving the determination of the fair market value of business interests of any type, including partnerships and proprietorships, and of intangible assets for all tax purposes.” (Rev. Rul. 68-609 (1967-1 Cum. Bul. 576).)

Several cases have discussed “factors” which a trial court should consider in determining whether the evidence presented supports a goodwill valuation. These factors are often mentioned as things which the appraiser failed to consider in valuing goodwill, and typically involve the business owner’s age, health, or desire to retire. Since these considerations relate to the future earning capacity of the owner-spouse, it could be argued that they are not part of the goodwill equation. (See “Pre-Marital and Post-Marital Efforts Excluded”.) It makes more sense to view these factors as affecting the capitalization rate, although the effect remains that future earning capacity is being considered. Here is an example of how the courts have dealt with this issue:

Certain matters merit consideration which may be said reasonably to contribute to, diminish, or affect the intangible value of professional goodwill at the time of dissolution and to the continuity and retention of the benefits thereof which the professional practitioner will continue to enjoy after the marital dissolution. In that context some such factors are the practitioner's age, health, past demonstrated earning power, professional reputation in the community as to his judgment, skill, knowledge, his comparative professional success, and the nature and duration of his business as a sole practitioner or as a member of a partnership or professional corporation to which his professional efforts have made a proprietary contribution. (In re Marriage of Rives (1982) 130 Cal.App.3d 138, 150, quoting In re Marriage of Lopez, 38 Cal.App.3d at pp. 109-110.) The court went on to

state: "In view of husband's advanced age and uncontroverted desire to retire, a goodwill factor far in excess of the value of the physical assets of the business was unjustified." (Id. at p. 152 (italics added).)

The potential loss of a major customer may also affect the goodwill value of a business. (In re Marriage of Rives (1982) 130 Cal.App.3d 138, 158.) However, this should probably not be considered unless the result is "immediate and specific." (See In re Marriage of Fonstein (1976) 17 Cal.3d 738 (discounting award of community asset based on income tax consequences).)

#### f. The Foster Method

Using the last three months of accounts receivables to value goodwill has been referred to as the Foster Method. (In re Marriage of Foster (1974) 42 Cal.App.3d 577.) The issue in Foster was whether the expert retained by a wife to value her husband's medical practice used "a proper method of evaluating goodwill ... and whether the evidence is sufficient to support a finding that the value of the goodwill of [the husband's practice] was the sum of \$27,000." (Id. at p. 580.) The expert for the wife explained that the fair value of a medical practitioner's goodwill could be determined as follows:

'One way is to take the net income for the year and subtract from that what a comparable employer [sic] would have as a salary in a comparable situation, and take that difference, and multiply that by a factor anywhere from, one year factor of anywhere from two to ten.' He testified further that 'You can take the net earnings of the business, one year's net earnings of the business. You can take two years net earnings of the business. You can take three years net earnings of the business. You can take three months charges to accounts receivable. You can take three months receipts on accounts receivable.' (Id. at p. 579.)

Although it is not entirely clear from the record which method the expert used, he testified that he "took the approximation of three months received on account, latest three months that I had, because some of the other ways I felt were resulted in a figure that was too high." (In re Marriage of Foster, supra, 42 Cal.App.3d at 581.) The court of appeal stated that "it is clear that at least one of these methods was utilized" and found that the expert's

testimony “provided sufficient evidence to support the sum of \$27,000 as the valuation of the goodwill.” (Id. at p. 584.) In other words, the court believed that the expert’s methodology was legitimate and that the opinion was supported by substantial evidence.

The Foster decision has been interpreted as approving, at least tacitly, any of the goodwill valuation methods described by the expert, which included (a) the excess earnings approach, (b) using the net earnings of the business over a one, two or three year period, or (c) using three months of accounts receivable. (See *In re Marriage of Foster*, supra, 42 Cal.App.3d at p. 579.) It has also been observed that the last two methods are not clearly defined in the case. For example, does the “net earnings of the business” include the spouse’s reasonable compensation? It is also not well understood why three months of accounts receivables would be used to value goodwill without taking into account the profitability of the practice.

The main point to be learned from Foster is that goodwill may be valued by any legitimate method. The holding in Foster makes this evident:

In sum we conclude the applicable rule in evaluating community goodwill to be that such goodwill may not be valued by any method that takes into account the post-marital efforts of either spouse but that a proper means of arriving at the value of such goodwill contemplates any legitimate method of evaluation that measures its present value by taking into account some past result. Insofar as the professional practice is concerned it is assumed that it will continue in the future. (*In re Marriage of Foster*, supra, 42 Cal.App.3d at p. 584.)

## 6. Accounts Receivable

For most professional practices, the major assets “are not capital assets, but those related to the direct rendering of professional services, most particularly accounts receivable and work in progress....” (*In re Marriage of Green* (1989) 213 Cal.App.3d 14, 21.) It is common for experts to discount accounts receivable for uncollectibility based on past collection rates. (See *In re Marriage of Nichols*, supra, 27 Cal.App.4th at pp. 667-668.)

## 7. Effect of Shareholder/Partnership Agreements

A shareholder or partnership agreement may sometimes be considered in valuing the community property interest in a partnership or corporation. (In re Marriage of Nichols (1994) 27 Cal.App.4th 661.) In Nichols, the court of appeal affirmed the trial court's reliance on a shareholder's buy-sell agreement which provided that the husband had no interest in the law corporation's accounts receivable, work in progress, or goodwill. (In re Marriage of Nichols , supra, 27 Cal.App.4th at pp. 671-672.) In assessing whether to use an partnership or shareholder agreement in valuing a community interest in an entity, the court in Nichols stated that the following factors should be considered:

(1) the proximity of the date of the agreement to the date of separation to ensure that the agreement was not entered into in contemplation of marital dissolution; (2) the existence of an independent motive for entering into the buy-sell agreement, such as a desire to protect all partners against the effect of a partnership dissolution; and (3) whether the value resulting from the agreement's purchase price formula is similar to the value produced by other approaches. (Id. at p. 672.)

The Nichols court also noted that personal goodwill may exist independent of the goodwill of the firm itself, stating that the "husband has personal goodwill regardless of whether he remains with the firm, and this goodwill cannot be eliminated by a recital in the stock purchase agreement." (Id. at p. 673, n. 4.)

The court came to the same conclusion in the case of In re Marriage of Iredale (2004) 121 Cal.App.4th 321. In Iredale, the wife was a partner in a large law firm. The community interest in the firm was valued in addition to wife's own personal goodwill. In doing so, the trial court used the partnership agreement as a reference to determine the community's specific interest in the firm. In upholding the decision, the court of appeal held that the wife's interest in the firm, pursuant to the partnership agreement she signed when she joined the firm

does not include an entitlement, at any time, to collect a portion of the accounts receivable, work in progress, or goodwill of the law firm. The trial court reasonably concluded that [the wife's] interest was limited to the value

of her capital account, which reflected the value of her interest in the hard assets of the firm, but not the firm's accounts receivable, work in progress, or goodwill. (In re Marriage of Iredale, supra, 121 Cal.App.4th 321.)

On the other hand, courts have disregarded partnership agreements in divorce cases. The typical rationale is that a partner's withdrawal rights under the partnership agreement is not relevant unless the partners actually intends to withdraw; instead, it is the community's interest in an ongoing business which is being valued in a marital dissolution action. (See In re Marriage of Fenton (1982) 134 Cal.App.3d 451.)

## 8. Discounts for Income Tax Consequences

Income tax consequences which are not "immediate and specific" are not considered when valuing community assets. (In re Marriage of Fonstein (1976) 17 Cal.3d 738.) The California Supreme Court stated:

Regardless of the certainty that tax liability will be incurred if in the future an asset is sold, liquidated or otherwise reduced to cash, the trial court is not required to speculate on or consider such tax consequences in the absence of proof that a taxable event has occurred during the marriage or will occur in connection with the division of the community property.

[Citation.]

(Id. at p. 748. fn. 5.)

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