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The Double-Dipping Arguments

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Should income used to establish asset value for division of property also be considered for spousal support? Is "double-dipping" an issue? Consider the following business valuation example.

A company is formed with a one-year contract to operate a concession stand at a local arena. The contract is signed on January 1, 2008, with the concession to be operational in the summer of 2008 with full payment due by November 2008.

The owner and spouse file for divorce early in 2008, and their attorneys agreed to a valuation date of December 31, 2007. It has been stipulated that the value of the business is to be split 50-50 between the parties. Payment to the nontitled spouse will take place at the end of 2008. The 2008 pro-forma financial statement is as follows:

Reported		Adjusted
$2,000,000	Forecasted Sales	$2,000,000
(1,050,000)	Less: Cost of Sales	(1,050,000)
(450,000)	Overhead Expenses	(450,000)
(500,000)	Actual Compensation	
	Reasonable Compensation	(300,000)
ZERO	Profit	$ 200,000

Assume reasonable officer compensation is $300,000. Therefore, adjusted profits for 2008 are $200,000 ($0 + $500,000 – $300,000). Since the business is expected to have a one-year life, the value of the business is then also determined to be $200,000. (For purposes of this example, income taxes and time value of money considerations were ignored.) The nontitled spouse is then awarded 50 percent of the value in a property settlement agreement, or $100,000.

In a separate hearing, spousal support is determined to be $250,000, equal to 50 percent of the titled spouse's expected income of $500,000. At the end of 2008, the nontitled spouse receives a total of $350,000 ($250,000 in spousal support, plus $100,000 in the property settlement). The titled spouse is left with $150,000 ($500,000 - $350,000). Using the owner's expected compensation of $500,000, rather than reasonable

compensation of $300,000, results in the nontitled spouse receiving more than 50 percent of the total combined income and property.

Retirement benefits

The double-dipping question has arisen in the context of distributing retirement plan benefits. Perhaps the earliest case against retirement plan double-counting comes from the Wisconsin Supreme Court, dating back some 40 years, Kronforst v. Kronforst, 21 Wis. 2d 54, 123 N.W.2d 528; 1963 Wis. Lexis 520. In this case, the Wisconsin Supreme Court determined that while it was appropriate for the trial court to distribute a portion (nearly half) of the husband's share of his retirement plan to his wife, it was inappropriate to then use the husband's share as a source for alimony payments, stating "such an asset cannot be included as a principal asset in making division of the estate and then also an income item to be considered in awarding alimony."

Minnesota and New Jersey have reached similar conclusions, in Walker v. Walker, 553 N.W.2d 90; 1996 Minn. App. Lexis 1040; D'Oro v. D'Oro, 193 N.J. Super. 385; 474 A.2d 1070; 1984 N.J. Super. Lexis 982; and Innes v. Innes, 117 N.J. 496; 569 A.2d 770; 1990 N.J. Lexis 9. In fact, the state of New Jersey has explicit wording in its divorce statute that prohibits a double count on pensions.

When a share of a retirement benefit is treated as an asset for purposes of equitable distribution, the court shall not consider income generated thereafter by that share for purposes of determining alimony.

New Jersey Code, N.J. Stat. Ann. 2A:34-23.

In the 1997 Virginia case, Moreno v. Moreno, 24 Va. App. 190; 480 S.E.2d 792; 1997 Va. App. Lexis 64, the court considered the husband's pension distributions as a source of spousal support as well as the wife's income from that pension in assessing her need for support. The court indicated that, unlike New Jersey, the Virginia divorce code contains no explicit prohibition on considering pension income for support purposes and that spousal support should consider the needs of the parties, among other factors.

Florida's rulings have evolved over time. Several cases have suggested that a pension could not be considered an asset and a source of income for alimony; see, for example, Rogers, 622 So. 2d 96; 1993 Fla. App. Lexis 7655, 18 Fla. L. Weekly D 1654; Bain, 687 So. 2d 79; 1997 Fla. App. Lexis 1384; 22 Fla. L. Weekly D 381; and Diffenderfer, 491 So. 2d 265; 1986 Fla. Lexis 2296; 11 Fla. L. Weekly 280. In 2005, the Supreme Court of Florida issued a ruling in Acker v. Acker, 904 So. 2d 384; 2005 Fla. Lexis 693; 30 Fla. L. Weekly S 235, which took a different view.

Charles and Barbara Acker's marriage was dissolved in 1993. In 1999, Mr. Acker retired and moved to terminate his ongoing alimony obligation since his income had declined. The trial court rejected this claim and in assessing his ability to pay took into account Mr. Acker's pension income. Mr. Acker then appealed to the Third District Court of Appeal, arguing the pension income had effectively been counted twice. The Third District commented in its ruling that a complicating factor in analyzing the issue was a significant

typographical error in the Diffenderfer decision reported in Westlaw and on CD-Rom. Specifically, the court noted that the following sentence in Diffenderfer was incorrectly reported:

If the wife, for example, has received through equitable distribution or lump sum alimony one-half of the husband's retirement pension, his interest in his pension [emphasis included] should not be considered as an asset reflecting his ability to pay.

Acker v. Acker, 821 So. 2d 1088; 2002 Fla. App. Lexis 6910; 27 Fla. L. Weekly D 1198.

The Third District, ruling in Acker, indicated the reference to "his interest in his pension" should actually say "her interest in his pension." It concluded that the incorrect wording caused courts over several years to erroneously interpret Diffenderfer and that, in actuality, "a court is allowed to consider a pension which has been equitably distributed to the payor in determining the payor's ability to pay alimony." Id.

Notwithstanding this distinction, the Third District concluded the error was academic because after the Diffenderfer ruling, the Florida Legislature created an equitable distribution statute and amended the alimony statute. The case cited a reference to the statute, which reads, "after the determination of an equitable distribution of the marital assets and liabilities, the court shall consider whether a judgment of alimony shall be made." Id. (Case cites § 61.075(8), Fla. Stat. (2001).) The court concluded that distributed pension assets could be considered for purposes of determining alimony.

The case was appealed. In 2005, the Supreme Court of Florida upheld the Third District's ruling. Based on the above, it appears that various jurisdictions are divided on how to deal with the possibility of double dipping on pension assets.

Equitable distribution and community property

Proponents of the double-dipping theory in business valuation see a close analogy to the issues with retirement assets. This analogy can be applied not only to the value of a business, but also to professional licenses, stock options, and intangible asset valuations such as patents.

As with retirement assets, a business (or other type of asset noted above) has a value that can be computed at the applicable date under state statute. Both of these assets can be divided and both will produce income into the future. The asset's future cash-flows are often what generate value.

Case law varies in how double dipping is treated in the valuing of a business asset, particularly in determining spousal support. Some courts have recognized the double-dipping issue and have ruled against its use; others have ruled it is not relevant and that lifestyle is more critical in determining spousal support. Most jurisdictions do not recognize double dipping for determining child support, because the most important factor is the welfare of the child. Opponents that recognize the double dip, but believe it is either permissible or irrelevant, suggest the increased property award generates investment income, which reduces the recipient spouse's support needs.

In some venues, the nontitled spouse may receive less than a 50-percent allocation, in recognition of a potential double-dip. However, property allocations of less than 50 percent also may account for other issues, including the possibility of taxes on sale, or the fact that the earnings stream from a small closely held business is inherently more risky than a diversified investment portfolio. Moreover, there may be a recognition that the owner has to "work the business" to maintain that asset in the future.

Following are decisions in a sampling of jurisdictions, including cases addressing the question of double dipping between the distribution of assets and child support.

In 1981, Holbrook v. Holbrook, 103 Wis. 2d 327; 309 N.W.2d 343; 1981 Wis. App. Lexis 3322, dealt with the value of a professional practice. The salary of the lawyer was used both as a basis for awarding alimony and then again as excess earnings, in computing the value of the practice goodwill. The Wisconsin Supreme Court ruled that:

The goodwill or reputation of the law firm is reflected in John's substantial salary. This salary was considered in setting the family support award. To also treat the goodwill of the law firm as a separate invisible asset would constitute double-counting.

For many years, courts in New York prohibited consideration as spousal maintenance the income used in the valuation of a license, degree, or certification, all of which are considered a marital asset if obtained during the marriage, consistent with New York law and the findings of the court in O'Brien v. O'Brien, 66 N.Y.2d 576, 489 N.E.2d 712; 498 N.Y.S.2d 743; 1985 N.Y. Lexis 17941. (See, for example, the discussion in the complicated case of Grunfeld v. Grunfeld, 94 N.Y.2d 696; 731 N.E. 2d 142; 709 N.Y.S.2d 486; 2000 Lexis 891, involving the value of a law practice and law license.)

Cases such as McSparron v. McSparron, 87 N.Y.2d 275; 662 N.E.2d 745; 639 N.Y.S.2d 265; 1995 Lexis 4451, and Grunfeld, among others, address the potential for a double count that could exist when a business or license is subject to equitable distribution and maintenance is awarded. As the Grunfeld opinion states, "Once a court converts a specific stream of income into an asset, that income may no longer be calculated into the maintenance formula and payout." However, treatment of this issue has further evolved with the issuance of Holterman in 2004 and Keane in 2006. (See below.)

Holterman v. Holterman, 3 N.Y.3d 1; 814 N.E.2d 765; 781 N.Y.S.2d 458; 2004 Lexis 1520, involves the valuation of the husband's medical license. The wife was awarded 35 percent of the marital value of Dr. Holterman's license at trial. The court directed the husband to make a payout to the wife as part of the property settlement over 15 years.

On appeal, the husband argued that his annual payment should be deducted from his child-support obligation and be included as income attributable to the wife; to do otherwise would be to "double-dip" from his earnings stream. However, the appellate court ruled there was no basis to support this claim, either under existing case law or from statutory authority.

The case was heard by the state's highest court, the court of appeals, which upheld the ruling in June 2004. It concluded the "Legislature did not wish to have a child's lifestyle

and support altered based on a distributive award." In its decision, the court of appeals noted that prohibitions on duplicative awards relate to equitable distribution and maintenance, not child support, making the husband's claim impermissible.

Unlike the prior New York cases, Keane v. Keane, 2006 N.Y. slip op. 9660; 8 N.Y.3d 115; 861 N.E.2d 98; 828 N.Y.S.2d 283; 2006 N.Y. Lexis 3751, dealt with tangible rental property. Mr. Keane owned a commercial rental property, which was valued using the income approach. The income approach to business valuation is one of the three primary approaches to determining value. Value is computed by converting the anticipated future earnings stream into a present amount or asset value. Other approaches include the asset and market approaches. The asset approach is based on the component tangible and intangible asset values of a business less liabilities. The market approach calculates the value of a business by comparing it to similar publicly traded companies or conducts an analysis of actual transactions involving similar businesses sold in the marketplace.

The trial court awarded equitable distribution, based on the value of the asset, and alimony from the income it generated. Mr. Keane appealed, arguing that doing so constituted a "double dip"; the appellate division agreed. Mrs. Keane then appealed to the court of appeals and won. The court of appeals differentiated between intangible business assets and tangible assets that can be distributed. The court found a distinction between a "tangible" asset, such as real property, and something more intangible, such as a professional license.

This difference was further analyzed in the Second Department's Appellate Division ruling in the Griggs matter (2007 N.Y. slip op. 7661; 44 A.D.3d 710; 844 N.Y.S.2d 351; 2007 N.Y. App. Div. Lexis 10599), which found that an interest in a business was a "tangible" asset. As such, the court found no double count in awarding a share of the business through equitable distribution and awarding maintenance. The appellate division cited Keane in its ruling.

Steneken v. Steneken, 183 N.J. 290; 873 A.2d 501; 2005 Lexis 578, involved the valuation of a closely held business, Esco. As part of the appraisal process, Gary Steneken's expert used the capitalization of earnings method to value Esco. This included a normalization of Mr. Steneken's salary to $150,000, as compared to approximately $208,000 in actual compensation in 1997.

The trial court accepted this valuation and awarded 35 percent of the value of the business to Marilyn Steneken. In determining alimony, the court used $150,000 as Mr. Steneken's income, rather than his actual income. Mrs. Steneken appealed. The appellate division upheld the value of Esco used by the trial court, but found the trial court had improperly used normalized income. This issue was reversed and remanded to the trial court.

On remand, the trial court determined that it had been "apparently in error" in its alimony determination and increased the alimony award to Marilyn Steneken. This led to an appeal by Gary Steneken, who argued the alimony award "constituted impermissible

double counting." The appellate division once again considered the issues of the case, and ultimately ruled in favor of Mrs. Steneken.

Valuation of the corporate asset was based on defendant's past earnings, not his future earnings. Obviously the effect of this approach was not to reduce the income actually paid to defendant in futuro…. Defendant's argument also largely ignores the fact that unlike the retirement benefit, it was his actual, not theoretical, income plus corporate perquisites that funded the upper middle-class lifestyle enjoyed by the parties throughout their marriage, and it is the marital standard of living that is the primary consideration in determining the initial award of alimony.…To allow plaintiff's distributive share of marital property to automatically defeat her needs-based claim would contravene the basic goal of alimony and result in the fundamental unfairness of having defendant alone partake in the benefit of future earnings in excess of "reasonable compensation."…

The court found the only statutory prohibition on double counting was with respect to pension assets and that it was appropriate to consider income from the business in determining alimony, "given the manner in which the marital lifestyle was historically funded."

The case was then appealed to the New Jersey Supreme Court, which upheld the appellate division's ruling in 2005. However, the supreme court eliminated one aspect of the lower court's rationale when it stated:

We expressly do not sustain the distinction made by the Appellate Division between the fact that "valuation of the corporate asset was based on defendant's past earnings, not his future earnings" whereas "defendant's actual current and future compensation may be treated as income for alimony purposes."

Heller v. Heller, No. 07AP-871 Court of Appeals of Ohio, Tenth Appellate District, Franklin County, 2008 Ohio 3296, Ohio App., June 30, 2008, is a recent case that involves a husband's 37.5 percent ownership in an S corporation. In addition to salary, Mr. Heller received bonuses, S corporation distributions, and various benefits as a result of his employment and ownership of the company, H & S Forest Products, Inc. The company was valued using the capitalized earnings method, which is one way to utilize the income approach to valuation. The value of the business is computed based on benefits (income or cash flow) available to the business and its stockholders. Typically, a single-period earnings stream derived either from prior or expected future performance is capitalized to reflect value. This normalized single-period earnings stream is considered representative of future results.

Mr. Heller's normalized salary determined by both appraisers was $300,000. His excess compensation was added back to company income. His two-year average compensation was $865,000, whereas his five-year average compensation was $615,000. Mr. Heller's interest in H & S was valued at $750,000, and 50 percent of the value was awarded to his wife as part of equitable distribution.

For spousal support, the trial court ordered Mr. Heller to pay $8,000 a month from his salary, plus 20 percent of each payment of additional gross income from the corporation as "additional spousal support." Mr. Heller appealed, claiming the "additional spousal support" was a double dip. The claim was based on the fact that earnings above the agreed upon reasonable salary amount was already accounted for in valuing the marital asset, the business. He further claimed that an award of 20 percent of profit distributions would be dividing the asset a second time. The appeals court responded:

[T]he novel question presented in the instant case is whether the trial court abused its discretion in drawing twice from the same well—defendant's share of H & S's future profits—in dividing marital assets and in ordering spousal support. For the following reasons we hold that this was an abuse of discretion.

Consequently, the Ohio Appeals Court concluded that there was a double dip and that it was impermissible. The court concluded that the valuation of H & S considered the discounted present value of the future earnings of the company, excluding Mr. Heller's annual salary. In summarizing its opinion, the court found:

In this case, the evidence clearly indicates that the value assigned to defendant's interest in H & S did not include defendant's compensation for his daily labor, but did include his share of all of H & S's future excess earnings; that is, it included the present value of all of defendant's future stock dividends. In making its property division, the Trial Court divided this asset equally between the parties. But the Trial Court then awarded to plaintiff, in addition to her one-half interest of that asset, another 20% of defendant's half… plaintiff receives her share of the total value of the business immediately by tax free offsetting assignment of other, presently liquid assets, while defendant cannot immediately reap the benefit of H & S's future excess earnings, and will be required to pay 20% of his share of the value once he receives it, even though plaintiff already will have received her share of this value.

In ordering this result, the court double dipped or awarded part of the same assets to plaintiff twice… trial courts may treat a spouse's future business profits either as a marital asset subject to division, or as a stream of income for spousal support purposes, but not both.

In McGregor v. McGregor, 2004 Mich. App. Lexis 2560, the husband argued in this court-of-appeals case that spousal support had been determined from the income of his businesses, but that 50 percent of the businesses' value had already been distributed to the wife. The court rejected this claim, saying that "defendant's argument of this issue is cursory, and he cites no case law or other authority to support it."

The Deluxe BV Update offered the following commentary on this decision: "The court's summary dismissal of a valid double dipping claim demonstrates the responsibility placed on experts and attorneys to provide the trial and appellate court with the information needed to make a favorable ruling." (www.bvlibrary.com, December 2004.)

Based on the analysis of cases above (and review of decisions from other states), it is clear that courts are divided on how to treat the possibility of double dipping relative to property distribution and spousal support. There is greater consistency on inclusion of income for child support that has already been considered for property distribution.

Stock options

As stated previously, the same type of issues can apply with respect to stock options. That is, should stock options be considered as an asset for purposes of property distribution, and their income, upon exercise, also be considered for alimony and child support?

Although there is less case law on the potential for double dipping on options, some states have considered both the asset for property distribution and the income for child support, just as these issues often are handled for the value of a business.

However, consideration of income from options for alimony has varied; some states have treated the options as an asset and others as income. For example, in the Minnesota case of Hamlin v. Hamlin, 1993 Minn. App. Lexis 1113, income from stock options was not considered in determining alimony, but the related asset was divided in a property settlement. Conversely, in the Florida case of Seither v. Seither, 779 So. 2d 331; 1999 Fla. App. Lexis 16816; 24 Fla. L. Weekly D. 28114, the court held that stock options should be treated as income for alimony where the options had not been considered for equitable distribution purposes.

Conclusion

We offer no opinions on the relevance of this issue from one jurisdiction to another. However, it is incumbent upon financial experts to be aware of the law in the state in which they are practicing, and to consult with the attorney to assess how the case law is to be interpreted. This is particularly important where the financial expert also provides other economic and tax consulting services, such as determining income available for spousal support and child support. In states where double counting is not yet an issue, appraisers and attorneys alike should be aware of the issue and potential dilemma.

This dilemma, faced by divorcing spouses, the court, family law practitioners, and financial experts, is perhaps best analyzed by reference to the Holbrook case referred to previously. In the classic double-dip scenario, the income generated by the husband (an attorney) provided both (1) cash flow used to pay alimony, and (2) part of the ultimate distribution of assets to be divided between the parties. The husband's cash flow is needed to keep both spouses at the same or similar standards of living as enjoyed prior to the divorce, but it also creates the asset value to be divided between the spouses.

Proponents of the double-dip argument believe there is too great a demand placed on that single earnings stream. Opponents argue the asset is no different than any other type of asset that generates income—for example, a Treasury bond. The bond would be distributed to the nontitled spouse, and the resultant income considered part of the earnings stream to that spouse, reducing the need for alimony. This issue—that the assets

provided to the supported spouse may generate income, which thereby reduces the need for alimony—may mitigate a portion of the double-dip argument. However, not only the amount of earnings generated from the asset should be taken into account. The relative liquidity and safety of the invested asset and earnings stream should be weighed against the relative illiquidity of the business and risk of continuity of the earnings to the business-owner spouse.

Thus, to resolve the financial aspects of the double dip, one may consider how financial assets resulting from an asset distribution can best be divided, how the resulting earnings stream can be used to meet lifestyle needs of the supported spouse, and how best to recognize the relative illiquidity of the remaining assets to the titled spouse and the overall demands on the earnings generated by the assets that have been divided. fa

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