Forensic Forum
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Calendar

Recent and Upcoming Speeches Include:

June 2004
16 The Shenkman Series – Shareholder Agreements (Teaneck)

August 2004
4 ICLE – Divorce Taxation (Fairfield)

September 2004
29 CPA Club of New Jersey - Business Valuation (West Orange)

October 2004
27 ICLE – Divorce Taxation (Mt. Laurel)

December 2004
9 CPA Club of New Jersey - Business Valuation (Saddlebrook)

January 2005
8 - ICLE - Divorce Taxation (New Attorneys Skills Set) (New Brunswick)
13 - Florida Institute CPAs - Forensic Accounting - Advanced (Ft. Lauderdale)
28 - ICLE - Determination of Income (Iselin)

February 2005
10 - Family Law Section - Looking Past the Date of Complaint (New Orleans)

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Our Litigation Team

- Kal Barson, CPA/ABV, CFE
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- Marizoil Delossantos, CPA
- Beth Doblosky, CPA, JD
- Stacey Jung
- Eric Malinowski, CPA
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- Janet Barson & Laura Casill (Editorial, Design & Layout)

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Back to the Future

One of the basic rules in business valuation - whether for divorce, shareholder suits, estate returns - is that the valuation is done as of a point in time. In a divorce case, it is typically as of the date of complaint; in a shareholder suit it would typically be either the date of complaint or perhaps the day before the alleged oppressive action began; and for estate returns, it's as of the date of death. Those who practice in areas which involve business valuation know full well that it is hardly unusual to have a situation where, by the time you reach serious discussions for settlement or trial, what was the value as at the original valuation date has now - allegedly - changed. Further, more often than not, any such allegations are that the value has declined, and usually those allegations are that it has declined significantly. Thus, the issue as to valuation subsequent to the otherwise recognized valuation date, and from the perspective of the valuation expert, in a sense, is how much do we look into the future, how much do we take a peek at subsequent events for valuation purposes.

This needs to be distinguished from the more straightforward valuation issue (even if from a legal perspective it is not so straightforward) of a valuation subsequent to the complaint date, but one which is likewise clearly defined. That is, a valuation expert really does not face a quandary if in a divorce matter we have a complaint date of December 31, 2002 and thus a valuation is done as at that date; and then afterwards we are advised to do a valuation as of December 31, 2003, June 30, 2004 or whatever. Our role is really no more complex and no more unusual - we are simply being asked to do another valuation. Someone else has made the all-important decision as to the valuation date.

The concern to be addressed herein is when we do not have that type of bright line new valuation date posed to us, but rather when we are working with what otherwise would be the recognized valuation date (let us assume again December 31, 2002), and it is late 2003 or early 2004, we are reviewing various financial documents in order to value the company as of December 31, 2002 and we become aware of significant changes in that businesses' fortunes. This is so whether the changes are for the good or the bad (though usually the concern tends to be greater towards the bad) and we are faced with the question as to how much of this type of subsequent event knowledge is relevant to our valuation. We may not be aware of this type of..

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Divorce Taxation: The Basics – our new book, 40 pages explaining Divorce taxation in layman's terms, is available – complimentary copies for the asking. Contact us if you haven't received your copy.

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subsequent event (because we have concentrated solely on events through the valuation date and have deliberately and professionally chosen not to take a peek forward), but these types of subsequent events are brought to our attention - often by the business owner who is bemoaning the current state of affairs.

We recognize that this type of issue has been addressed in a couple of noteworthy cases. For instance, in *Goldman,* the ultimate worthlessness of the Company a few years subsequent to the date of complaint dictated that it was treated as worthless for purposes of equitable distribution, even though it was worth a significant sum at the date of complaint. *Goldman* however, is too simple - that famous bright line - the Company was actually worthless before the case reached trial. Then there is the more recent *Ciasulli*, where the Court found that an increase in value subsequent to the date of complaint was fair game, because a part of that increase was passive in nature. However, neither *Goldman* nor *Ciasulli* are on point for the issue being raised here. That is, in both cases there was a clear change in value at some point in time subsequent to the date of complaint - and, no suggestion was made that those changes subsequent to the date of complaint would cause the value as of the date of complaint to differ. These were subsequent event situations. We go back to the focus of this article - that is we are dealing with only one valuation date, but we question to what extent, if any, we are to use subsequent information.

There are a number of issues, some practical, some theoretical, that need to be considered in this exercise.

• We tend to be in a court of equity. Isn't it equitable (or perhaps is it not) to recognize a significant change in value subsequent to the date of complaint, so that neither party to the litigation receives an unfair advantage.

• However, is that change subsequent to the date of complaint, let us say a reduction in sales volume, a real change, is it divorce planning, is it merely a cyclical change, is it reasonable to expect that the following month or the following year things will revert back to where they were. In other words, is it a real change, or is it merely a temporary blip in operations.

• Virtually all of the situations we have seen where concerns have been expressed as to subsequent events deal with where the subsequent events are negative - where arguably the value has gone down. Why is that - if the argument as to equity is to hold water, would it be just as fair to take changes into account when they are upwards rather than downwards.

Calendar

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March 2005

13 Men's Club Temple Sholom - Tax Update (Bridgewater)

May 2005

7 NJSCPA/Family Law Section – Tax Issues in Business Valuation (Iselin)

December 2005

9 Florida Institute CPAs - Proving & Challenging Unreported Income (Ft. Lauderdale)

Ongoing

The BARSON GROUP CLE Series

- June 1, 2004
- June 3, 2004
- June 8, 2004
- June 21, 2004
- October 2, 2004
- October 5, 2004
- October 6, 2004
- November 1, 2004
- November 2, 2004
- November 8, 2004
- November 17, 2004

Recent and Upcoming Media Situations:

• ***Book – Second edition of Investigative Accounting in Divorce*** by Kal Barson, published by John Wiley and Sons

• ***Book – Divorce Taxation: The Basics*** – by the Staff of The BARSON GROUP

• ***Chapter – Divorce Taxation - NJ Family Law*** by Lexislaw (Scheduled for April 2005)

• ***Article – Value to the Holder – Valuation's Nadir?*** – American Journal of Family Law (Summer 2004)

• ***Article - The Elements of a Business Valuation Report*** by Marshall A. Morris –American Journal of Family Law (Fall 2004)

• ***Article – The CPA's Role in Estimating Business Damages*** by Marshall A. Morris – Middlesex County Bar Newsletter *(January 2005)*

• ***Article – Divorce Taxation*** – *New Jersey Lawyer* (January 24, 2005)

• ***Article – Forensic Accounting – A Force for Good*** – to be in New Jersey Family Lawyer (mid 2005)

• Every business fluctuates. Some months are better than others, some years are better than others. If there is a change (whether for the good or the bad) how are we supposed to know - without keeping the window open and looking forward even more - if that change is temporary or permanent. At what point do we stop the clock, at what point do we stop looking forward.

• To a degree, the risk of business worsening, as well as the potential for business to improve, are factors that the valuation expert must take into account in developing his/her approach to valuation and in a typical situation, in the build-up of the cap rate. If those factors are reasonably and adequately accounted for in that process, then what has happened subsequent thereto is not relevant, because the reasonable expectations and risks of the future have already been taken into account.

• In a real world application sense, the concept of a rigid valuation date (the date of complaint) is perhaps illogical. If we were to look at this from the point of view of a real transaction, and the as of date for the change in hands of the business was December 31, 2003, it is virtually a physical impossibility for the calculations and determination of value to be done precisely as of December 31, 2003 and at the same time close the deal at that point. If the target is for the business to change hands December 31, 2003, you know that there have been negotiations going on for some time before (months or even longer), and that the buyer and seller have been using and relying on financial data from some time in the past. That time in the past, for our purposes, can be considered the date of complaint. However, even though that so-called date of complaint is the date being used, as a very real and practical aspect of the transaction, the buyer and the seller are continually looking at the business' operations. You can be certain that consideration of some kind is being given by both parties - the seller being concerned that if the business is doing better he/she gets the optimum price; and the buyer paying acute attention so if there is any downturn to the business he/she does not overpay. In a sense, you might argue that a rigid date of complaint value is really a fiction of convenience.

• Businesses fluctuate all of the time. Putting aside whether it is a permanent or a temporary fluctuation, we have the issue as to whether it is a significant enough fluctuation to cause a change in our value conclusion. What is significant? Any dollar guideline would be difficult, because a $100,000 potential change in value on a $300,000 asset is a very different matter than a $100,000 change in value on a $5 million value asset. On the other hand, if we were to look at it from a percentage point of view, a 10% change in a $300,000 asset, when you take into account the likely disagreement as to how much of a change happened and whether or not it is to be taken into account, and then with the allocation percentage, there probably is not enough money in it to warrant considering those factors. On the other hand, the same 10%, applied to a $5 million business, very well may be of significant enough dollars to warrant a more full-fledged attack. To add to all of that complexity, what about when we are only dealing with a piece of that business - and therefore the dollar amounts (of particular concern on the low end) are even less.

• Venturing into the very muddy waters of active versus passive, if we are looking at subsequent events, but nevertheless valuing the business as at the original date of complaint, are we as valuation experts going to be faced with one or both sides looking to establish some grounds for whether the change was active or passive. And that, certainly for you attorneys, is going to bring out just the true meaning of the word advocacy. Will this in turn bring in matters of changing what otherwise would be the distribution allocation percentage. If so, aren't we simply playing mind games, playing havoc with social policy, in addressing a possible valuation concern.

• Ultimately, if one side or the other pulls subsequent events into the date of complaint value, isn't it likely that we can expect the other side will want to keep the door open - and if that is the case, for how long - to see if, to challenge whether, the change was real, temporary, cyclical or whatever. And if it did, would not one side or the other then bring in the argument, let us say if there was a recovery from the change, that the recovery was as the result of active or passive forces - depending on who you were representing and what suited your client's interests.

Clearly, there is a legitimate area for disagreement and varying opinions. The typical reality is that for most of what we do we are dealing in a court of equity - which dictates that future events of substance cannot be ignored. That does not change the problem as to what is of substance, and even if of substance, is it merely cyclical, or is it permanent. And, is it only our imagination, or does it seem that this matter seems to arise almost only when business is doing worse subsequent to the complaint date, virtually never when it is doing better.

FOCUS ON FUN

Accountants & Humor – a Sociological Fable

Exempt status was denied to an association formed to relocate homeless persons because its activities were designed to rid the area of those persons, rather than to benefit the homeless. More than an insubstantial part of the association's activities benefited the private interests of its creators.

Although her husband was in prison, the taxpayer was capable of filing their return, and therefore the late filing penalty was properly imposed. In addition, the substantial understatement penalty was also sustained in light of their failure to adequately disclose the receipt of embezzlement income on their return. This little snippet gets even more interesting - they were found not liable for the negligence penalty because it did not occur to them to report the embezzled funds.

Public policy precluded allowing an individual to claim a casualty loss deduction following the destruction by fire of his residence and its contents after he intentionally set fire to his wife's clothes. His position was that if he couldn't have them no one would. The Tax Court noted that although negligence on part of the taxpayer would not bar entitlement to a casualty loss deduction, such a deduction would not be permitted where gross negligence was involved. In an obvious juxtaposition of cause and effect, the Court held that the destruction of the taxpayer's home was a foreseeable consequence of setting fire to the clothing. Further, the mere fact that he was not tried for arson did not preclude the Court from holding that he had violated the state's public policy against arson and burning.

Winter

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