

# Fair Value – Fair to Whom?

Ilan Hirschfeld, CPA/ABV/CFF, MBA

Fair Market Value and Fair Value are both important terms in valuation. However, they are frequently mistakenly thought to be interchangeable. This is a common misconception as these two Standards of Value differ not only in their origins, but significantly in their applications.

The term “Fair Value” is a contextual and geographically sensitive term. It is a Standard of Value created by statute and/or precedent for specific circumstances to implement a specific public policy. The New Jersey Family Courts approach valuation from the perspective of fairness to the specific parties as opposed to Fair Market Value, which focuses on theoretical willing sellers and buyers. In this manner the Courts have created, through statutes and case law, a New Jersey version of value. This specific standard of value, uniquely developed to be applied for the specific circumstance of divorce, implements the public policy of treating marriage as a partnership.

Our courts’ viewpoint of valuation deviates from established valuation theory in the attempt to invoke the unique circumstances and characteristics associated with matrimonial matters. Before the Supreme Court’s decision in Dugan, it was generally accepted that all marital assets should be valued in matrimonial litigation predicated on the asset’s Fair Market Value. The Dugan decision introduced a new concept into the dialogue: while Mr. Dugan’s practice could not be sold, it had value to its owner. In order to be fair to the non-titled spouse, a value other than “Fair Market Value” needed to be utilized in valuing and equitably distributing business interests. Certainly, Dugan is an example where the value of the law practice was greater to Mr. Dugan than any value he could receive for his law practice in the marketplace.

Under *Brown v Brown*, 348 N.J. Super. 466 (App. Div. 2002), the element of fairness under the circumstances is effectively addressed: “While there is no ready market for the shares and consequently no fair market value of [the husband’s business, the husband’s] shares in the going concern have value to him and to his co-owners that does not depend upon a theoretical sale to an outsider and has not changed as a result of the divorce complaint or judgment.”

The Internal Revenue Service (“IRS”) is regarded by many as the primary theoretician in the field of valuation of closely held businesses. Fair Market Value as defined under Revenue Ruling 59-60 is “the price at which property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.” Although 59-60 is now almost 60 years old, it continues to exert great influence on business valuation standards. However, what many practitioners may have forgotten is that it was originally developed by the IRS in the context of tax compliance for estate and gift tax purposes only.

As there is a large body of interpretive case law, many accountants and appraisers have relied on Fair Market Value as the standard of value for assets and



real estate. However one must ponder whether this is a relevant standard of value when valuing a business in a divorce matter where no one is actually selling the business nor is there even a willing seller or buyer. The blind utilization of 59-60, predicated on death and taxes, would theoretically result in a valuation that would be oblivious to the unique and relevant facts and circumstances in divorce matters.

So, what is fair when a marriage between two “partners” comes to an end? Should we be looking at value from the perspective of what could be realized through the sale of the business when, in fact, no one is really selling anything? How should we address the fact that, subsequent to the finalization of the divorce, the business owner will go on running the business and enjoy, in part, the fruits borne from the efforts and varied forms of investments made during the marriage?

There are also circumstances where the Fair Market Value of the business could exceed the value to the holder of the business. This may result when valuing companies in industries where there are many active buyers having resulting in many dozens of transactions (e.g. automobile distributors, etc.). Would it be fair to use Fair Market Value under those circumstances thereby effectively forcing the owner to sell the business?

There clearly is an issue related to the so-called “double-dip”. However, while this is an issue, it is not a factor, nor a component, of what should be considered in the business valuation. It is an issue of allocation and not one of valuation. The level and duration of the support payments, in conjunction with the equitable distribution of the business interest, are matters that fall under the purview of legal counsel and the Courts and not factors that come into play in the determination of the value of the business itself. In *Orgler*, the court held that taxes are a factor to be considered in effectuating equitable distribution, not in the valuation of the asset itself. Similarly, in *Painter* the decision expressed the view that taxes should “effect the allocation itself” and not the valuation.

We should be attempting to determine the value specifically to the business owner who will be retain-

## MARCUM LLP

**Contact:** Ilan Hirschfeld, CPA/ABV/CFF, MBA

**Address:** 105 Eisenhower Parkway, Suite 301  
Roseland, NJ 07068

**Phone:** 973-646-3700

**Fax:** 973-646-3701

**Email:** ilan@marcumllp.com

**Website:** www.marcumllp.com



ing and operating the business. This is precisely what the owner will be enjoying henceforth, as opposed to determining the value that the business could immediately be sold for. The focus should be on the present value of the future income and benefits that the business owner will personally derive from the continued ownership of the business. The cash flow, perquisites, benefits, appreciation, etc. in the future will all now inure to the business owner – all of which the spouse will forgo as a consequence of the divorce. By determining the present value of these various components you will have found a value that is “fair” and consistent with public policy in divorce.

Typically, as of the date of complaint, we know that the sale of the business was not imminent, the business operator wasn’t retiring, and the business operator was still alive (*although some spouses have been known to have questioned this as well during the marriage*). Therefore, the appropriate purpose in valuing the business at the date of complaint is what it was worth, at that time, to that specific business owner, as a going concern into the future. A standard that appropriately reflects this concept would thereby capture the real value that the marital partnership created.

The scenario of the continued operation of the business, as opposed to the imminent sale of the business, is an integral factor in the determination of the real marital equity of the ownership of the business. Whether we call it Fair Value, Divorce Value, or even an Affair Value (as certain litigants have labeled it), it must ultimately be fair in recognizing the particular circumstances of the dissolution of the marriage and not a transaction involving the sale of a business. Fair Value measurements in a divorce must be considered from the economic perspective of the business owner who already owns and will maintain ownership of the business. Perhaps the concept of a “Marital Value” would be the appropriate here - a value that is fair in a divorce setting.

EVER WONDER  
**WHERE THE  
PEOPLE WITH  
ALL THE  
ANSWERS,  
GET ALL THE  
ANSWERS?**

**ASK  
MARCUM**

**MARCUM**  
ACCOUNTANTS & ADVISORS

**marcumllp.com/njlj**

Contact **Ilan Hirschfeld** or **Tom Keane** at:

**ROSELAND, New Jersey** • 105 Eisenhower Parkway • Roseland, NJ 07068 • 973.646.3700  
**NEPTUNE, New Jersey** • 3443 Route 66 • Neptune, NJ 07753 • 732.922.9900  
**NEW YORK, New York** • 750 Third Avenue • New York, NY 10017 • 212.485.5500