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We Value Both Real Estate and Businesses
Including Machinery & Equipment

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Appraisals for Divorce: The Big Issues

Appraisals prepared to assist with any type of litigation are expected to be challenged, however, those prepared to assist with a property settlement in a divorce seem to be among the most contentious assignments. It is “normal” for the appraiser to be given slanted information—the business or professional practice is often painted as an outstanding performer by one party, and on the verge of going bankrupt by the other. It all depends upon whether you are talking to the spouse that operates the business or the “out” spouse.

Generally, the spouse that is operating the business claims that he or she is so critical to the continued success of the business that without their services, the business would be rendered worthless. While it is important to have someone knowledgeable about the business operations running the business, it is very rare that a particular person is irreplaceable in regard to a business entity. For the purpose of the appraisal, the business income stream needs to include a “market” salary amount that would be needed to pay another person with similar skills and experience. There have, however, been a few occasions where I have witnessed the business operating spouse stick to their guns, declaring that the business was worthless without them, and that they would not give the other spouse any compensation from the business. Unfortunately, such declarations rarely have a place in a divorce, and such actions have led to the business closing down, assets liquidated, and a job obtained from a former competitor at a substantial reduction in pay. As such, this type of action seems to be a bit rash and short-sighted.

On the other side of things, I have observed cases in which the non-operating spouse has demanded such a large payment for one-half of the business or professional practice, that in order to pay it, the business would have to be sold or liquidated leaving the operating spouse in a very bad position. Both of these situations are unfortunate and benefit no one in the long run.

In most states, business valuations for divorce use the Fair Market Value Standard of Value. This standard of value is best defined as:

the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a **hypothetical willing and able seller**, acting at arm’s length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.¹

It should be specifically noted that the value developed under the Fair Market Value standard of value is hypothetical; i.e. **no sale is going to take place** and it is a **major assumption that the seller is both willing and able to sell!** I have often been told by an operating spouse of the business or professional practice that they would not cooperate if the business were sold and thus the business or professional practice value should be a lot less. They have missed the point – the value should be computed “as if” they were planning on selling and were willing and able to do so.


¹ Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweih, Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. (New York: McGraw-Hill, 2000), p. 913.

The spouse that is not involved in operating the business needs to also understand that the value of the business or professional practice must be what “**a hypothetical willing and able buyer**” would pay for the business when “**acting at arm’s length in an open and unrestricted market**, when neither is **under compulsion to buy** or sell and when both have **reasonable knowledge of the relevant facts.**” The value conclusion must be supported by what a buyer would pay for the interest owned in the business or professional practice. Often, the final conclusion in a business appraisal is supported by what is called a Purchase Justification Test. This test of reasonableness shows what would likely happen if a buyer were to purchase the business for the appraised value with a “typical” cash down payment and financing at typical market terms. If the value conclusion is reasonable, this Purchase Justification Test shows that the buyer would be able to make the loan payments, pay himself or herself a reasonable market salary from the business, and receive a typical cash on cash return on the down payment.

In my opinion, the value conclusion for the business or professional practice interest in any type of appraisal engagement should be “fair and reasonable,” however, in engagements prepared for divorce they should be thorough, well written, and clearly illustrate that the value conclusion is truly “fair and equitable.” The appraisal should walk the reader through the process and clearly illustrate how the value was developed and supported so that each side realizes that the value conclusion makes sense.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**

Sincerely,



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