SPECIAL "VALUES" ISSUE

The Family Law Section

# COMMENTATOR

Volume XXII, No. 4 Summer 2006

Carin Porras, Ft. Lauderdale, and Susan Trainor, Tallahassee

## IN THIS ISSUE:



## *Coming up!*

**2006 General Meeting of Committees & Sections:**
September 13 - 16, 2006
Delray Beach Marriott

**2007 Midyear Meeting of Family Law Section**
*(in conjunction w/ Marital & Family Law Certification Exam Review Course)*
January 25 - 27, 2007
Grand Floridian
Orlando

**2007 Annual Meeting of The Florida Bar**
June 27-30, 2007
Marriott World Center
Orlando

# You can add value

***Message from the chair***

**by Jorge M. Cestero, Esq., West Palm Beach**

I know that this is supposed to be a valuation themed issue of *The Commentator*, so please forgive my tangent. As my term as chair of the Family Law Section draws closer to its end, I am proud to reflect upon the actions of section members that have added value to my life, to the practice of family law and to the public.

What is the value of education? The CLE and Cert Review committees have put on the most comprehensive, educational and financially successful slate of seminars in the storied history of our section. Led by Tom Sasser, Peter Gladstone, J.J. Dahl, Patty Alexander, Alex Caballero and Jennifer Harrington, the work of these committees in teaching us how to better serve our clients and the public was *invaluable*.

Clarence Darrow once said, *"Laws should be like clothes. They should be made to fit the people they serve."* When I recently saw the quote, I was reminded of the "value" added to the citizens of our state by the actions of our Legislation Committee this year. Vast improvements in adoption, relocation and paternity legislation were spearheaded by the committee chaired by G.M. Diane Kirigin. Section members went to Tallahassee and worked with our lobbyist and Tallahassee legend, Fred Dudley. Already on the plate for next year are rewrites of our parenting law (see last issue) and child support as well as the Uniform Premarital Agreement Act. In working on these issues, we have formed stronger relationships with other organizations that add value, such as the American Academy of Matrimonial Lawyers, the Florida Coalition Against Domestic Violence and the Florida Association of Family and Conciliation Courts.

Many members of the section heeded my call to represent a child in crisis on a pro-bono basis. Our mentoring program,

*continued, next page*

New theme!

## MORE THAN A SEMINAR ... IT'S AN EVENT!!!

Bigger room block!

***Same location, but different venue!***

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The Florida Bar rate is $175 per night s/d occupancy.

# From the editor

**by Carin M. Porras, Fort Lauderdale**


C. PORRAS

Here it is— our issue on values. We have put together a number of articles on valuation topics and hope you will find them useful and valuable to you in your practice.

Jim Hart from Orlando, a new member on the Publications Committee, has written a concise article, "Tools for asset valuation," in which he provides some good starting points for the family law practitioner. Jim's article is followed by a wonderful contribution from the always informative Scott Rubin. I think you will find Scott's article, "Valuation opinions by non-experts," easy to read and full of "value."

We then change gears with Dr. Hugh Leavell's piece titled, appropriately, "What's in a value?" Dr. Leavell has a different perspective on the worth of "things," and it is one we wish more of our clients would think about before spending tremendous amounts of money on items of insignificant value.

Moving on to weightier topics, we have "The value and nature of business goodwill after *Held v. Held*," authored by CPA Luisa K. Bosso of West Palm Beach. Luisa's valuable article is followed by an equally informative one on "Valuing stock options in a dissolution case," an always complex topic. Alex Caballero of Tampa does an excellent job of presenting the issues involved in this valuation problem.

***We do hope you will find these articles "of value" ... when you wrestle with some of the complex valuation issues presented in dissolution of marriage actions.***

We're not done yet. Tim Voit from Naples, an expert on the valuation of retirement benefits and the preparation of the dreaded QDRO, dispels retirement plan valuation issues in defined benefit pension plans. And Jeff Schneider, a certified divorce financial analyst who helps a spouse going through a dissolution proceeding understand the financial aspects of his or her divorce, writes on "Valuing various retirement plans and stock options." Joe Hood from Tampa also contributes a hot tip: "Requests for admission re pension values." Financial advisor Regina Bedoya provides a practical article, "If I could do it all over again ... Financial lessons learned from divorce." We conclude with Jerry Reiss' article, "Anatomy of commingled funds: Untying the knots with new theory."

We do hope you will find these articles "of value" to you when you wrestle with some of the complex valuation issues presented in dissolution of marriage actions. And we also hope you will join us at some or all of the Family Law Section activities, meetings and seminars described and listed in various places in our newsletter. You can tell by the photographs included in this issue that there is a lot of fun mixed in with our committee and section work!

Our next issue will focus on the different challenges posed by representing persons in different occupations. How do you best represent a public figure? A government official? A member of the judiciary? An actor or actress? A real estate broker? A physician? A professional athlete? A newscaster? The CEO of a big company? Please share your experiences with us. What are the problems when dealing with a party in one of these (or other) occupations? What are the problems when you represent the spouse of one of these people? Your contribution does not have to be long, nor formal, nor contain cites or footnotes. We're looking for hot tips, practice pointers, helpful websites—as well as articles, which can be as short as you like.

My email address, that is, my correct email address, is *cmporras@bellsouth.net*. Please share your skills and knowledge to make all of us better lawyers and practitioners.

## Chair's message

*from page 1*

allowing non-family lawyers to be mentored in a pro-bono case, continues to gain momentum. We could not have done it without Kim Rommell-Enright and the initiative of Past Chair Evan Marks. I thank all of you who added value to the lives of others in our state by participating in these programs. Keep up the good work!

Of our 3,500 section members, perhaps 200 are truly active. You can add value by becoming active. Incoming Chair Tom Sasser has pledged that if you want to be on a committee, he will give you your first choice. You can add value by representing a child on a pro-bono basis. You can add value by getting involved. You can *receive* value as well. Some of my best business and social relationships have been forged in the section. Being active in the section can be a profitable proposition, both intellectually and financially.

The way I see it, the Family Law Section is truly an *invaluable* organization. Working closely with Tom, Allyson Hughes and Scott Rubin has been awesome. The Executive Council has exceeded all expectations. I have been honored and blessed to serve as your chair this year. Thank you and best wishes for a safe and wonderful summer.

# Mark your calendar!

***(Look for brochures in the mail and information on the Family Law Section's website.)***

## 2006

***July 19, 2006***
**Family Law Telephonic Legislative Update Seminar [C0385]**

***July 27 - 30***
**The Family Law Section Leadership Retreat**
*The Ritz-Carlton Golf Resort, Naples*
Mandatory attendance for all Executive Council members.
A retreat for all section members interested in being more active in the section and serving as section leaders.
Special room block rate of $135 per night, s/d occupancy
Call for reservations: 1-800-241-3333 or 1-239-593-2000

***August 2***
**"Family Law Ethics – A View From the Bench" Telephonic Seminar [C 0386]**

***September 8 - 9***
**The Florida Bar Family Law Section General Meeting**
(NOT in conjunction with The Florida Bar meetings)
*The Delray Beach Marriott*

***September 8***

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| 9:00 a.m. – 5:00 p.m. | **Committee meetings** |
| 5:00 p.m. – 7:00 p.m. | **Section Membership Reception** |

***September 9***

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|---|---|
| 9:00 a.m. | **Executive Council Meeting** |

Special room block rate of $129 s/d occupancy
Call for reservations: 1-561-274-3200

***September 20 - 21***
**Children's Issues CLE Seminar [C0394]**
*Ft. Lauderdale & Tampa*

***October 11 - 15***
**The Family Law Section Fall Retreat**
*The Equinox Resort, Manchester Village, Vermont*
Enjoy the changing of the leaves during "prime foliage" season. Special room block rate: $295 with $19 resort fee
Call for reservations now, *limited number of rooms*: 1-802-362-4700

***December 6***
**Mechanics of the Marital and Family Law Certification Telephonic Seminar [C0412]**

## 2007

***January 25 - 27***
**Family Law Midyear Committee Meetings & 2007 Matrimonial & Family Law Certification Review Course [C0422]**
*Returning to the Grand Floridian Hotel, Disney World*
Room rate: $175 per night, s/d occupancy
Call for reservations: 1-407-824-1383

***March 15 - 16***
**Equitable Distribution CLE, Ft. Lauderdale & Tampa [C0440 ]**

***April 19 - 22***
**Family Law Section Spring Retreat**
*The Hilton Key West Resort & Marina*
Group room block rate: $295 per night, s/d occupancy
Call for reservations: 1-305-294-4000

***May 16***
**Telephonic Military Affairs Seminar**

***June 27 - 28***
**The Florida Bar Family Law Section Annual Meeting**
*Orlando Marriott World Center*

***June 27th***

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|---|---|
| 8:00 a.m. | **Welcome Breakfast** |
| 9:00 a.m. – 5:00 p.m. | **Committee meetings** |
| 12:00 noon – 2:30 p.m. | **Membership Awards & Installation Luncheon** |
| 6:00 p.m. – 8:00 p.m. | **Section Membership Reception** |

***July 18***
**Family Law Section Telephonic Legislative Update**

***August 2 - 4***
**Family Law Advanced Trial Advocacy Seminar**

# Tools for asset valuation

**by James Hart, Orlando**


J. HART

*Disclaimer: In almost all cases, it is safer for you to use an expert (usually a certified financial analyst or investment advisor) for complex asset valuation. Despite this fact, this article should provide some insight into how various assets, including small businesses, are valued. Regardless of whether or not you have any experience in finance, the information provided in this article will be a good starting point for any practitioner trying to value assets.*

**What type of asset are you trying to value?**

Depending on the type of asset you are valuing, the process of determining an appropriate valuation will vary in difficulty. For example, stock and mutual fund values can readily be found in the daily *Wall Street Journal*. However, the values for various bonds, annuities or other types of assets may not be readily found in the newspaper, so you will probably have to consult with an investment advisor whom you trust. He or she will have access to more sophisticated valuation tools that will allow him or her to value these complicated assets.



**What about small business valuation?**

Small business valuation can be an art form in and of itself. As a result, it is best to hire an expert financial analyst who can conduct a thorough financial and operational analysis of the business and its operations. There are several ways that such an expert will value a business, and each method begins with looking at the financial statements. (Those readers who don't like math can stop right here and just hire the expert!)

An expert financial analyst will take a two-step approach to valuing a business. The first step is to look at the financial statements and begin the not-so-simple task of crunching numbers. Three main techniques can be used to analyze financial statements:

- **Discounted cash flow analysis**: The analyst will look at the company's current cash flow, project (estimate) what the future cash flows will be and discount those numbers back to a present value.
- **Appraisal of current assets:** The analyst will determine what the company's property, plant and equipment are worth.
- **Comparative analysis:** The analyst will compare the business being analyzed to the selling price of other similar companies recently sold.

Each of these methods will yield a slightly different picture of what the company is worth, and combined they will provide a rough estimate of what the company as a whole is worth.

In the second step of the analysis, the financial analyst will assess the company's market value. In this part of the process, the analyst will consider various economic and market conditions, which may include the length of time the company has been in business, determining who the company's competitors are and evaluating the strength of the company's customer base, among other market-based factors. The analyst should also conduct a thorough due diligence review of the overall operations of the company. Once this extensive review is complete, the analyst will issue a formal valuation opinion and report.

**What tools can help?**

*CFO.com* provides numerous free online tools to a family law practitioner that can be used to help provide some guidance and financial estimates prior to hiring a professional financial analyst. These online tools include calculators to help determine the value of a business or calculate the price of bonds, options or futures.

Additionally, a number of companies sell business valuation software. Simply Google "business valuation software," and a variety of websites will pop up.

**Bottom line**

Regardless of the valuation you are contemplating, it is in your client's best interest to hire an independent, expert financial analyst to assess the value of complicated financial and business assets. When choosing an expert, be sure to look at his or her track record of testimony and ask for the names of attorneys who have used his or her services in the past. Ask to see copies of expert reports that he or she has prepared and determine whether or not the information can be transferred into a format that can easily be presented to a judge. Make sure the expert can present findings in plain language that can easily be understood by a judge. Although there are countless technology tools that can be used to help in asset valuation, there is simply no substitute for a competent expert who will make a favorable impression at a hearing or in a deposition.

***James Hart** is a family law lawyer practicing in Orlando. For more information on his practice, please visit www.jameshartlaw.com.*

# Valuation opinions by non-experts

**by Scott L. Rubin, Miami**


S. RUBIN

Your client tells you she owns a piece of property in Canada she has never seen, which was a gift from her aunt. She owns a 30-percent interest in a local business, which is where she works. Her parents, who own the balance of the business, gave her the interest during the marriage. She owns jewelry and antiques, some of which were purchased for her by her husband during the marriage and some of which are family heirlooms. Her uncle from Kentucky gave her a racehorse last year. She has named the horse and hopes to see the horse for the first time this summer. Her home is owned jointly with her husband, who is a physician. Her husband owns his own practice, and when he was first getting started, she helped out by doing the bank deposits and paying the bills. Her husband also owns the vacation home in the North Carolina mountains, where your client and the children spend most of the summer months.

There is no agreement as to the value of any of the foregoing assets. Do you need a whole slew of experts to testify concerning the value of these assets? Can your client testify to the values of all of these assets? Some of them? Can other laypeople give opinions of value?

Let's start with the basics. The Florida Evidence Code deals with opinion testimony in Sections 90.701 through 90.706. Section 90.701 states

> witnesses who are not testifying as experts can only give opinion testimony when the witness cannot readily, and with equal accuracy and adequacy, communicate what he or she has perceived to the trier of fact without testifying in terms of inferences or opinions and the witness's use of inferences or opinions will not mislead the trier of fact to the prejudice of the objecting party; and the opinions and inferences do not require a special knowledge, skill, experience or training.

A witness qualified as an expert has no such limitations. Experts can give opinion testimony, even on ultimate issues, so long as the expert is qualified by "knowledge, skill, experience or education," according to Sections 90.702 and 90.703. That would make it appear, at first blush, as if only a witness qualified as an expert can give an opinion of value; however, that is not how the case law has evolved.

In the criminal law context, an owner is generally presumed as competent to testify to the value of his stolen property. *Mitchell v. State*, 31 Fla. L. Weekly D190 (Fla. 2d DCA 2006). That rule, however, comes with a caveat.

> Mere ownership, however, is insufficient, and the witness must have personal knowledge of the property. *I.T. v. State*, 796 So.2d 1220 (Fla. 4th DCA 2001).

> The owner with that knowledge may establish the value ... by direct testimony of fair market value or through evidence of the original market cost of the property, the manner in which the items were used, the condition and quality of the items, and the percentage of depreciation of the items since their purchase. *Pickett v. State*, 839 So.2d 860 (Fla. 2d DCA 2003).

In *Mitchell, supra*, the owner had personal knowledge of the cell phone and tape recorder taken and was, therefore, competent to testify to their value. Unfortunately, the only testimony elicited from him at trial was the initial purchase price of the items and that they were in working order. Since there was no evidence as to the condition, quality or age of the items or any depreciation as of the time they were stolen, the conviction for first degree petty theft was reversed.

The criminal law cases even permit testimony of value from a person not the owner, so long as the witness' personal knowledge of the property and its value is demonstrated. See, e.g., *Freeman v. State*, 909 So.2d 965 (Fla. 3d DCA 2005); *I.T. v. State, supra*; and *Taylor v. State*, 425 So.2d 1191 (Fla. 1st DCA 1983).

In the civil law context, the rule of law permitting an owner to testify concerning the value of property has been established in Florida for many years. In *Atlantic Coast Line R. Co. v. Sandlin*, 75 Fla. 539, 78 So. 667 (1918), the Supreme Court of Florida quoted holdings from eight other states and aligned itself with them, holding that the cost of a thing is some evidence of its value and that ordinarily the owner is presumed to have such familiarity with the personal property as to know pretty nearly, if not actually, what it is worth. Thus, the owner's testimony as to the cost of the harness that was destroyed by fire before delivery was considered competent to establish the value of the harness for the calculation of damages.

Florida courts have declined to extend the doctrine that an owner is competent to testify to the value of property to allow corporate officers to testify to the value of corporate property. *Mercury Marine Division of Brunswick Corporation v. Boat Town U.S.A., Inc.*, 444 So.2d 88 (Fla. 4th DCA 1984). However, if a corporate officer is qualified by virtue of his experience, his management of the affairs of the corporation and his knowledge of relevant value, he is also a competent witness as to value. *Mercury Marine, supra; Salvage & Surplus Inc. v. Weintraub*, 131 So.2d 515 (Fla. 3d DCA 1961). Similarly, the facilities program director for the Orange County Public School System was held to be qualified to testify concerning the damages caused to a school by rusted air handler stands not specified for installation. *Reliance Insurance Co. v. Pro-Tech Conditioning & Heating*, 866 So.2d

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**Valuation opinions**
*from preceding page*

700 (Fla. 5th DCA 2003), *rev. denied*, 866 So.2d 700 (Fla. 2003).

In a footnote, the Fifth District Court of Appeals raised, but did not determine, an interesting issue. In *Vaughn v. Munn*, 826 So.2d 1094 (Fla. 5th DCA 2002), a home purchaser brought fraudulent disclosure and breach of contract actions against the sellers. When the purchaser was asked his opinion concerning the value of the structure "at the time of purchase," there was an objection based upon the witness' lack of expertise. After an off the record bench conference with the judge, the question was withdrawn and the witness was asked his opinion concerning the value of the home on the day after he purchased it. Thus, the question exists as to whether a purchaser is competent to testify to the value of an item prior to the actual purchase of it.

Turning next to family law cases, the courts clearly embrace the doctrine that an owner of an asset is competent to testify concerning its value. In *Akers v. Akers*, 582 So.2d 1212 (Fla. 1st DCA 1991), *rev. denied*, 592 So.2d 679 (Fla. 1991), the court quoted *Florida Jurisprudence* and the case of *Hill v. Marion County*, 238 So.2d 163 (Fla. 1st DCA 1970), for the general principle that "ordinarily, an owner is qualified to testify to the value of his own property." In the *Akers* case, the wife complained that the trial court had accepted the values attributed by the husband to jointly owned real estate rather than accepting her values. She asserted that the trial court should have appointed an independent appraiser in light of the disparity in the parties' testimony. She lost that issue. The appellate court made it clear that the trial court was completely justified in accepting one party's opinion of value over the opinion of the other party. Seven years later, *Akers, supra*, was cited as authority for the court accepting the opinion testimony of the wife over that of the husband concerning the value of two jointly owned residential properties in *Crockett v. Crockett*, 708 So.2d 329 (Fla. 1st DCA 1998). Similarly, a court is free to accept the valuation opinions of one party and that party's expert over the opinions of the other party and his or her expert. *Adkins v. Adkins*, 650 So.2d 61 (Fla. 3d DCA 1994).

The opinion of an owner may even be more persuasive to the court than the testimony of an expert concerning the value of an asset. In *Misdraji v. Misdraji*, 702 So.2d 1292 (Fla. 3d DCA 1998), the trial court's use of the wife's opinion as to the value of the marital home over that of a "professionally prepared appraisal" was affirmed.

While a court is not obligated to accept the value advanced by either party [*See, Moon v. Moon*, 594 So.2d 819 (Fla. 1st DCA 1992)], it may not choose a value that is lower than either party claimed it to be. *Fugina v. Fugina*, 749 So.2d 570 (Fla. 5th DCA 2000).

Although the court is not obligated to accept either party's opinion of value, it seems that family courts will allow the owner to testify without any requirement that the owner have personal knowledge of the value. In *Russell v. Russell*, 711 So.2d 1300 (Fla. 2d DCA 1998), the court held that the husband's acknowledgment that his certified public accountant had valued his medical practice at a specific amount was adequate competent evidence of value.

Curiously, however, family courts seem less liberal than their criminal or civil counterparts to expand the doctrine to allow a non-expert non-owner to testify concerning the value of an asset. For example, in *Beatty v. Gribble*, 652 So.2d 1156 (Fla. 2d DCA 1995), there were four marital parcels of real estate titled in the name of the husband. As an "owner," the court found his estimates of value to be competent. The wife's testimony was determined by the appellate court not to be competent because she was not an owner, despite the fact that her testimony was based upon prior statements to her by the husband concerning the value of those assets!

In *Noone v. Noone*, 727 So.2d 972 (Fla. 5th DCA 1999), the court held that the wife was not competent to value the husband's jewelry, because

she did not own it and had no basis to make a credible estimate. Her financial affidavit, which valued the 14-year-old jointly owned furniture at $10,000, and the photographs of it she introduced were determined to be competent evidence because she was "a joint owner of the furniture."

In any family or civil court in Florida, an owner can testify concerning the value of property that he or she owns. The court, however, can reject the testimony. In civil and criminal courts, non-experts who do not own property, but have sufficient familiarity with it, can testify concerning its value. It appears to be fairly debatable, however, whether such testimony would be considered competent in a family case.

So, back to your client. Clearly she can testify concerning her opinion of value of all of the assets in her name. It is questionable, however, whether her opinions concerning the value of her husband's practice and the vacation home will be considered competent, notwithstanding their qualification as marital assets.

***Scott L. Rubin*** *practices throughout South Florida with Fogel Rubin & Fogel. The AV-rated firm has offices in Miami and Key West. Mr. Rubin has been an attorney for 21 years and has been board certified in marital and family law since 1992. Mr. Rubin served as the exam consultant for the Marital and Family Law Certification committee for three years and is a former chair of that committee. He now sits on The Florida Bar's Special Committee to Study Paralegal Regulation. He is the secretary of the Family Law Section and has served on the section's Executive Council for over 12 years. Mr. Rubin has lectured, led a litigation workshop and been published in family law. A cum laude graduate of the University of Miami Law School, Mr. Rubin is a member of the American Bar Association, the Dade County Bar Association, the Monroe County Bar Association and a founding member of the First Family Law American Inn of Court.*

# What's in a value?

**by Hugh R. Leavell, Ph.D., Jupiter**


H. LEAVELL

I decided to bid for some items on Ebay. It was my first time. I was an Ebay virgin, you might say. I know why it took me this long. I'm one of those people who likes to wait until I really want something before I buy it. Maybe I like my money too much. But I sure hate to part with it once it's in my pocket. To me, that rainy day always seems to be lurking right around the next corner. I've heard there are some people who aren't that way.

Certainly, there are some who don't care much about holding onto their money. For them, the only value it has is what it can buy. They want the stuff, not the loot. Moolah is just a tool. They don't believe in any rainy day. And for many, it's not even a question of money. They don't have any! But so what? They buy whatever they want on credit. And pay for it someday, I guess. Along with lots of interest, you bet. That is, if they don't go Chapter 11 first!

They say one man's trash is another man's treasure. And I'm sure that's true. There's a lot of stuff on Ebay you wouldn't want. But someone will want it and buy it, too. And some of them will turn right around and resell the same stuff to someone who wants it even more. I have some neighbors who do that all the time. They buy stuff at yard sales and then resell the exact same stuff at their own yard sale a few days later. And make a profit!

Value appears to be an entirely subjective determination. It just depends on who's doing the looking. And it's not only economics I'm talking about. Anything we care about has value to us, often out of all proportion to any objective criteria. Take grandchildren, for instance.

Today a guy came up to me in the gym and immediately started telling me all about his grandchildren. I don't know what made him think I wanted to hear it. Now that I think about it, maybe he didn't care what I wanted. Maybe he's so fascinated with the little dears he just loves to talk about them to anyone. I'm thinking that's the explanation. People are like that with their health, too. They'll talk and talk about that. I guess it's because, like family, it's the most important thing they have (or don't have). They're enthralled by it. And so they keep talking … and talking.

The things we care most about are not possessions. Oh, toys are nice, and they can impress others and make them think we're real successful, whatever that means. But I'm pretty sure most people realize that real success isn't about having a lot of stuff. And even happiness isn't necessarily the be-all, end-all of existence. If it weren't for misery and grief we'd have precious little art and very few inventions. All the creative people would be whistling fancier versions of *Dixie* or something equally foolish, frivolous and fun. Still, everyone has to evaluate things in their own terms. It's a subjective call.

I have a philosophy about wealth that has served me pretty well and probably reflects my own values. I say a person is rich according to what he can afford to live without. If you don't miss it and don't want it, then you certainly don't need it. Thus, not having it is not a hardship. In fact, not having it is even better than having it because then you don't have to do the maintenance on it, provide the security for it or pay the taxes on it; and it doesn't take up any space in your mind or your garage, either. I call that a bargain!

***Hugh R. Leavell, Ph.D.,*** *is a marriage and family therapist, mediator and parenting coordinator in private practice in Jupiter and West Palm Beach. His weekly column appears in the Jupiter Hometown News and was for ten years a regular Friday feature in the Palm Beach Post. Some of his columns can be seen at www.oneminutetherapist.com. He is a member of the Collaborative Divorce Team of the Palm Beaches and can be reached at 561/471-0067 or hughleavell@adelphia.net.*

# The value and nature of business goodwill after *Held v. Held*

**by Luisa K. Bosso, West Palm Beach**

*Thompson v. Thompson*, 576 So.2d 267 (Fla. 1991), was a landmark case in Florida, which found that personal or professional goodwill is not a marital asset subject to equitable distribution. In *Thompson*, the court discussed the definition of goodwill and looked to other Florida cases for guidance.

"This court has defined goodwill as the advantage or benefit a business has beyond the value of its property and capital." *Swann v. Mitchell*, 435 So.2d 797 (Fla. 1983).

However, the court later went on to carve out that component of traditional goodwill that represents the reputation and skill of an individual:

> Irrespective of the setting in which it is found, the meaning of goodwill does not change. It is property which attaches to and is dependent upon an existing business entity; the reputation and skill of an individual entrepreneur—be he a professional or a traditional businessman—is not a component of the intangible asset we identify generally as goodwill. *Hanson v. Hanson*, 738 S.W.2d 429, 434 (Mo. 1987).

The court then gave the following guidance: "It should be emphasized that such goodwill, to be a marital asset, must exist separate and apart from the reputation or continued presence of the marital litigant."

Enterprise goodwill is "separate and distinct from the presence and reputation" of the individual owner. In contrast, personal and professional goodwill represents the relationships, skill and reputation of the individual owner. In *Walton*, the court further determined that for enterprise goodwill to be considered a marital asset there must be competent evidence that the enterprise goodwill is separate and apart from the personal goodwill of the owner. It appears that if it is proven that goodwill exists in a business, there is a presumption that it is personal goodwill, not subject to equitable distribution, unless there is conclusive evidence that the goodwill is enterprise.

As a practical matter, it seems that in Florida most judges make a distinction and consider any goodwill of a nonprofessional commercial business as enterprise goodwill and any goodwill of a professional practice as personal goodwill.

Although the case law does not provide specific guidance on how to determine whether goodwill is personal and professional or enterprise, it does mention some criteria that should be considered. One of the criteria mentioned is a non-compete agreement. The courts make note that if a non-compete agreement is required to sell the business at a certain price, that would be an indication the goodwill is personal. But the courts also clearly state that the determination of whether personal or enterprise goodwill exists and the value of such should be considered on a case-by-case basis**.** If a non-compete agreement is a true indicator of the presence of personal goodwill in a business, then the goodwill in the majority of not only professional practices, but also small commercial businesses, would be personal. Most purchasers of small commercial businesses insist on a non-compete agreement from the seller. Pratt's Stats, a database reporting the details of over 7,500 business sales, reports that over 60 percent of small businesses that sold for less than $500,000 included a non-compete agreement from the seller. Most business brokers who handle small business sales advise their clients selling commercial, nonprofessional businesses that a non-compete agreement will probably be required by the buyer. Less than 20 percent of those businesses with a sale price over $5 million included a non-compete agreement. Based on the statistics derived from actual sales, as reported by *Pratt's Stats*, the requirement of a non-compete agreement is more a function of the size of a business and its total value rather than whether the type of business is commercial or professional.

Furthermore, the requirement of a non-compete agreement as an indicator of the existence of goodwill is additionally troublesome because the standard of value in Florida courts for marital dissolution purposes is purported to be fair market value. Fair market value is defined as "what a willing buyer would pay, and a willing seller would accept, neither acting under duress for a sale of the business." The courts have also stated that in considering other comparable sales in the valuation process, "the sale must be one [that] eliminates any further personal influence which the seller might have over the business." *Walton v. Walton*, 657 So.2d. 1214, 1215 (Fla. 4th DCA 1995). This conflicts with traditional business valuation principles and the concept of fair market value of a business because, presumably, if a seller is willing and desirous of selling his business, he would willingly sign a non-compete agreement and perhaps be willing to stay on for a while to transition the sale. Most likely, a business cannot be sold for the true fair market value unless the seller is willing. This is true for most businesses, regardless if they are commercial or professional enterprises. The seller's cooperation in the sale and transition of his business is critical in getting the best price. As proof of the importance of the seller's willingness to obtain the best price for the business, empirical studies have been performed wherein there was a sudden death of a business owner. Mary Ann Lerch noted in her December 1992 article for *Business Valuation Review* that, as a rule of thumb, a 35-percent "key man" discount is subtracted

*continued, next page*

**Business good will**
*from preceding page*

from the value of a business to account for the loss of a key individual. Her study, which included only publicly traded stocks, was undertaken to find out if the traditional key man discount was actually justified. She concluded that, with the loss of a key person, there was either a significant effect on some of the companies or none at all. She also concluded that if the impact of a loss of a key individual was present, it had dropped from about 35 to 40 percent in the 1970s to about 20 to 25 percent in the 1980s. The reduction in value of the company was the highest with companies that did not have depth of management. I would expect that closely held companies, which would have much less depth of management than the publicly traded companies that were included in the study, would experience an even greater loss of value upon the loss of a key person.

The dilemma for business valuation professionals who are testifying as experts is that there are established methodology and standards for valuing an enterprise as a whole. There are also established methodology and standards for determining the existence and amount of goodwill for a business. However, there is not established methodology for separating out what portion of the goodwill of a business is professional and what portion of the goodwill of a business is enterprise. Mark Dietrich, in his two-part article published in the spring and summer 2005 issues of *CPA Expert*, has made a valiant attempt to create a usable model to measure the personal portion (and by elimination the enterprise portion) of the goodwill of a business enterprise. Dietrich states in the first part of his article:

> There are two fundamental issues in differentiating personal goodwill from enterprise goodwill:
>
> 1. Identifying which portions of cash flow are attributable directly to the individual's characteristics.
>
> 2. Identifying which cash flows attributable to otherwise enterprise-level tangibles and intangibles would be lost if the individual competed.

In other words, how would the cash flow of the business be affected if the individual owner not only: 1) left the business; but also 2) directly competed with the business. I can find no fault with the logic of this approach to valuing the personal and professional goodwill, for it does carve out the value of the owner's continued presence in the business.

As a practical matter, it may not be possible to obtain the information needed to properly use this model in an adversarial proceeding such as a divorce. In most cases, the information needed to complete the model could only be obtained from the owner of the business.

To illustrate this point, in the second part of his article, Dietrich provides a list of steps the business valuation professional must perform to quantify the value of personal goodwill. Some of these steps are

1. Identify any "off the books" intangibles, such as workforce in place; client lists; and special processes developed, etc. An intangible that is "off the books" may not be identifiable or valued without the owner's assistance. As an example of how workforce in place can affect the value of a business, several years ago I was involved in the valuation of a company that laid cable within buildings, including cable for network systems for computers. The initial analysis of the cash flow of the business indicated the presence of goodwill, but the comparable sales of similar businesses indicated a much higher value than what I expected. Through reading an industry magazine, I was able to contact and speak to a business broker who specialized in the sale of these types of businesses. He advised me that in this particular industry, the rule of thumb was that these types of businesses were selling for about $100,000 per trained employee and equipped work vehicle. This was an "off the books" intangible asset (workforce in place) that I discovered by luck and perseverance. Most likely, the owner was aware of this intangible asset; although, when I interviewed him and asked what he felt the business was worth, he did not mention this rule of thumb to me. It would be difficult to value any "off the books" intangibles without the owner's input and cooperation.
2. Determine the probability of the seller competing with the purchaser. This is a key element of calculating step 2 of Dietrich's model. Unless the owner is dead

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or seriously ill, how can one determine the probability of the owner competing with the purchaser without input from the owner? If the standard of value is fair market value, does that not assume that the owner is willing to sell and will agree to not compete with the seller?

3. Obtain and read all contracts between the valuation subject and its employees. How can the expert of the non-propertied spouse be sure that all of the contracts have been provided? This limits the cash flow produced by the workforce in place that could be lured away by the owner if he left the enterprise.

In the Fifteenth Judicial Circuit of Palm Beach County, some business valuation experts have concluded that the recent decision in *Held v. Held* has upturned the apple cart and opened the door to the premise that the goodwill of commercial businesses as well as professional practices is personal. In *Held v. Held*, the husband owned an insurance agency that sold commercial insurance to homeowners' associations. The adjusted book value of the agency was $2,918,655; and the fair market value, which the court concluded included enterprise goodwill, was determined to be $10.5 million by the trial court. On remand, the trial court was directed to use the lower value of $2,918,655. The appeals court determined the goodwill of the insurance agency to be personal goodwill. One has to wonder whether in a non-alimony case, the appellate court would have reached the same decision if the agency was the sole marital asset and the book value was zero and the fair market value was $300,000. I do not believe that the *Held* case will make any dramatic changes to the valuation of businesses for divorce purposes. I believe the determination of whether goodwill exists and if it is personal or enterprise goodwill has always been arguable and that, as in the past, the courts will continue to determine the existence and nature of the goodwill on a case-by-case basis. There will continue to be a great deal of subjectivity and uncertainty in this area.

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# Valuing stock options in a dissolution case

**by Alexander Caballero, Tampa**


A. CABALLERO

At one time stock options were only reserved for high level executives of companies. More recently, stock options are being provided to employees at all levels for numerous reasons, such as a form of compensation, as a carrot to keep employees from leaving the company or as a "buy in" to associate the company's success with the employee's success. A company may award stock options as compensation for past services or performance, as an incentive to remain with the company or to garner favorable tax consequences. Regardless of the reason for the stock option, stock options may or may not be a marital asset that needs to be analyzed as part of a dissolution proceeding.

In analyzing stock options the following terms may be encountered:

**Stock option** - An employee's right, granted by a company, to purchase a specified number of shares of the company's stock at a specified price during a stated period of time. (L. Kinnell, Tax Treatment for Stock Options Transferred Pursuant to Divorce, AAML Website, November 2003.)

**Vested** - A stock option is vested if it is not forfeited by the employee if he or she leaves employment. (Id.)

**Non-vested or unvested** - A stock option is unvested if it is held conditionally and the employee loses it in the event of employment termination. (Id.)

**Mature** - When the option is actually exercisable it is said to be mature. (Id.)

**Exercise or strike price** - The purchase price per share of an option, which is usually the market price of the stock at the time of the grant of the option. (Id.)

**Exercise date** - The date upon which the holder of a stock option "calls" or purchases the stock at the price specified by the original grant of the stock option. (Id.)

**Compensatory or nonqualified, non-statutory stock option** - Stock options granted by a company to an employee in lieu of monetary compensation that are regulated by IRC §83, the income from which is taxed at ordinary rates when granted if the option has a readily ascertainable fair market value. See Treas. Reg. §1.83(a) and Treas. Reg. §1.83-7(a). However these stock options often do not have a readily ascertainable market value and, therefore, the employee is usually taxed as of the date of exercise versus the date of grant. (Id.)

**Incentive or qualified, statutory stock options** - A stock option provided with favorable federal tax treatment subject to certain conditions set forth herein. These stock options are granted to an employee who must have no greater than 10 percent of the voting power of the company. Moreover, the exercise price must be no less than the market price at the date of the grant of the stock option. Additional conditions or restrictions include that incentive stock options may not be sold within two years of the date of the grant or within one year of the date of the exercise. These stock options are governed by IRC § 422 and § 423. If one complies with these rules there is no tax consequence upon the grant of incentive stock options, nor is the employee taxed upon the exercise of an incentive stock option. Upon the sale, however, the employee pays either the capital gains rate or the higher ordinary income rates depending on how long the stocks were held. With this type of stock option, subject to meeting the above conditions, the employee is taxed only when he or she eventually sells the incentive stock option shares and then only at capital gains rates. The gain would be calculated as sales price less the option price at the exercise date. (Id.)

If stock options are vested, they may be considered marital if issued during the marriage. The real issue of whether stock options are marital or non-marital is when the options are not vested or unvested and thus whether they have been earned or not during the marriage. Even if stock options are not vested and require the employee to continue to work at the company for the options to vest, the options may be determined to be marital or non-marital depending on other factors.

In *Ruberg v. Ruberg*, 858 So. 2d 1147 (Fla. 2d DCA 2003), the Second District Court of Appeal held that *unvested* stock options and restricted shares issued to the husband were non-marital because they were granted in consideration of the husband's future job performance and not based on his past efforts. The wife had argued that unvested stock options were marital assets because they were rewards for the husband's past job performance, that is, his job performance during the course of the parties' marriage—and thus constituted deferred compensation. (Id.)

The issue in *Ruberg* is whether the stock options were granted for past services rendered, which would mean they were deferred compensation and thus marital because the options were "earned" during the marriage or whether the stock options were granted for future job performance and thus not "earned" until a later time. *Ruberg* makes clear that the issue is not just when the options were granted or whether a party has to continue to work at the company to have the options vested. The court stated that "not all options granted prior to the cutoff date for the determination of marital assets are deferred compensation. The critical factor in determining the nature of options that have not vested by the cutoff date is the

predominant purpose for which the options were given." (Id.)

In determining that the unvested stock options and the restricted options were non-marital, the *Ruberg* court looked at the following facts:

1. the provisions of the company's stock option plan document, which stated that the purpose of the options were "attract [ing] and retain [ing] the best personnel available ... and to provide additional incentive to such employees to exert their maximum efforts toward the success of the [c]ompany and its subsidiary corporations";
2. the long-term incentive plan document, which stated that the purpose of the options were to "attract and retain and provide incentives to employees, officers, directors[,] and consultants ... and to thereby increase overall shareholder value"; and
3. the individual "incentive" stock option and restricted share agreement executed by the husband and his company, which stated that the purpose of the options were "as an incentive for [husband] to advance the interests of the company." (Id.)

The issue of whether unvested stock options are marital or non-marital property subject to equitable distribution will be a factual question. All documents, records, witnesses and other evidence must be looked at to determine why the stock options were granted.

In *Jenson v. Jenson*, 824 So. 2d 315 (Fla. 1st DCA 2002), the First District Court of Appeal looked at the issue of whether unvested stock options may constitute marital assets as an issue of first impression in Florida. The argument against unvested stock options being marital property was that the options were not capable of being valued or transferred and that the Legislature did not provide for such treatment in its definition of "marital assets" under §61.075(5)(a), Fla. Stat.

The court in *Jenson* found that the stock options were marital because they represented past commendable employment to the company that the employee had provided during the marriage. (Id.) The court held that notwithstanding the lack of value of an unvested stock option, such options gained prior to the filing of a dissolution petition do represent assets that were accumulated during the marriage and are thus subject to equitable distribution. (Id.) The court did not address, nor did the parties argue, that the unvested stock options were granted for future job performance or for any post-filing purposes.

In *Seither v. Seither*, 779 So. 2d 331 (Fla. 2d DCA 1999), the court did not treat unvested stock options as an asset, but instead considered them as income available to the husband for both alimony and child support. Therefore, even if the court determines that unvested stock options are non-marital, they can still be considered income for alimony and child support purposes. The issue then becomes determining the value of unvested stock options that may not vest until some time in the future when they will have some unknown and unpredictable value.

The *Seither* court established the value as testified by a certified public accountant that calculated the value as the actual stock's worth at the time of the final hearing multiplied by the amount of option shares involved. The court held that if the value of the stock falls significantly below the certified public account-ant's prediction, this change should be regarded as a potential ground for modification of alimony.

Once it is determined that the stock options are marital, the next question that arises is how they are valued. The courts have primarily employed these methods of valuation:

1. Net present value;
2. Deferred distribution; and
3. Reserved jurisdiction.

**Net present value**

Economists, especially in the investment field, have devised various methods to determine a present value of stock options. However, unreported decisions have indicated that one such method, the Black-Sholes method, does not appear to be an accurate method for valuing employment issued stock options in a marital context. *Murray v. Murray*, 1999 WL 55693 (Oh. App. 1999); and

*continued, next page*

**Valuing stock options**
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*Chammah v. Chammah*, 1997 WL 414404 (Superior Court, Conn. 1997); and *Wendt v. Wendt*, 757 A.2d 656 (Superior Court, Conn. 1997). The difficulty in the present value method is that, although an unvested stock option may have an intrinsic value (the difference between the market price and the value of the stock option when granted), the market price on the date the option will be exercised is extremely difficult to predict. Intrinsic value does not take into consideration any increase in the stock market price that may occur in the future between the date of issue and the date the option is exercised. The deferred distribution and time rule methods avoid these difficulties.

**Deferred distribution**

The deferred distribution method entails the trial court devising the non-employee's percentage share in the stock options in advance of receipt of the benefits.

A majority of courts that have examined whether unvested stock options vest after separation or service of the petition have accepted two primary time-rule formulas for allocating unvested stock options. *Brebaugh v. Deane*, 118 P. 3d 43 (Az. App. 2005). The first is the *Hug* formula (enunciated in *In re Marriage of Hug*, 201 Cal. Rptr. 676 (1984)), which is most appropriate for stock options that are granted for past services but cannot be exercised until after the separation or service of process because the formula gives more weight to the employee's entire tenure with the employer during the marriage. (Id.) The *Hug* formula is

> the number of options determined to be community/marital is the product of a fraction in which the numerator is the period in months from the commencement of the spouse's tenure with his employer to the date of the couple's separation, and the denominator is the period in months between commencement of the employment and the date when each group of options first becomes exercisable. This fraction is then multiplied by the number of shares of stock that can be purchased with each block of options, yielding the community/marital figure.

The other formula, the *Nelson* formula (enunciated in *In re Marriage of Nelson*, 222 Cal.Rptr. 790 (1986)), is more appropriate for stock options that are intended to compensate an employee for future efforts. The formula assumes that the period of employment prior to the granting of the option did not contribute to the employee earning the stock options and should not be included in the time used to calculate the community's interest in the options. The *Nelson* formula is

> the numerator of the fraction is the number of months from the date of grant of each block of options to the date of the couple's separation, while the denominator is the period from the time of each grant to its date of exercisability. This fraction is also multiplied by the number of shares to be purchased to determine the community figure.

Other methods of valuation are used by other jurisdictions. See: *Brebaugh v. Deane*, 118 P. 3d 43 (AZ. App. 2005), citing cases from Idaho, New York and Washington, which employed different methods of valuation. As stated in *Brebaugh*, because the nature of stock options differs and trial courts will have to resolve options on an ad hoc basis, a single formula for valuing stock op-

tions upon dissolution is not appropriate.

**Reserved jurisdiction**

Reserved jurisdiction permits a trial court to wait until the benefits are actually received and to divide them at that time. This last method allows the trial court the flexibility to consider any changes in circumstances that have transpired during the interim period between dissolution and receipt of benefits.

The distribution of stock options must be carefully analyzed by the practitioner. Once stock options are identified, the issue then becomes determining if they are vested or unvested and the timing of the vested options. When considering unvested stock options, all documents and records regarding the company's stock option plans and descriptions of those plans as well as the specific documents provided to the employee when the options were granted should be carefully examined. In addition, people knowledgeable about the company's stock options should be interviewed, and testify at any hearing, to determine the purpose of the options. Determining whether unvested stock options are marital property is a very fact intensive question that is important to analyze in a dissolution action.

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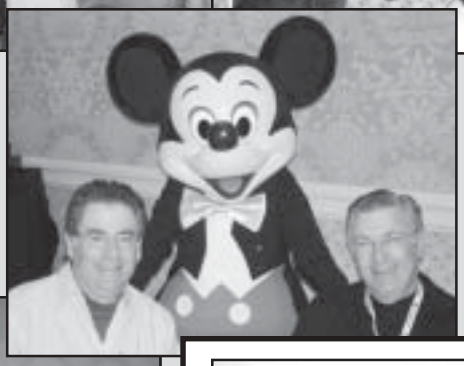

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# Dispelling retirement plan valuation issues

by Timothy C. Voit, Voit Econometrics Group Inc., Naples

The courts, attorneys and alike are often confronted with valuations regarding retirement plan assets in a divorce, viewing some valuations with skepticism. Why would someone base a settlement of one of the largest of marital assets on a subjective value, and why do there seem to be different approaches? On top of this, how does a QDRO (qualified domestic relations order) fit into the overall realm of dividing up this marital asset?

First and foremost, this article will emphasize defined benefit pension plans, those designed to pay out a monthly retirement benefit, as opposed to 401Ks or defined contribution plans, which are plans with simply an account balance usually comprised of marketable securities (investment accounts or funds). The only valuation issue in defined contribution plans tends to be determining the marital and non-marital components. It is the valuation of pension benefits that creates the most controversy and results in trial appearances by one or more experts.

Determining the value of a future cash flow stream—a future promise of a benefit—may seem somewhat risky; however, after examining a few facts, I think you will find that whether the pension benefit is valued and offset or divided by a QDRO creates no unfair advantage to one or the other party in a divorce. This is because the future cash flow stream is deeply discounted for time as well as for mortality, the probability of death of the plan participant spouse.

In short, the present value of a pension benefit means bringing back or converting a cash flow stream into a lump sum. It is commonly referred to as the present value of an annuity, a lump-sum value at retirement necessary to fund the retirement benefit. The question is what does it take today, in terms of a lump sum, to fund a future cash flow stream? The point here, and it cannot be overemphasized, is that the cash flow stream is deeply discounted for time. For instance, rather than saying that at the time of retirement it would take $250,000 to fund a monthly retirement benefit of $3,000 per month, at present it would require $125,000, assuming the participant is 15 or 20 years from retirement.

The portion of the pension fund allocated to the participant's accrued benefit has time to grow. So, in essence, rather than adding up the payments for an estimated or anticipated period of time during a payout period and saying that the total payout of the pension is "x," we bring that value back into today's dollars. If you then factor in a discount for mortality (which often may be 20 percent), the overall discount of the pension benefit can be as much as 70 percent, a bargain for the participant spouse. Even if the participant spouse has terminated employment as of the valuation date, simply based on time, the *value* of the pension benefit continues to increase since the discount for time is less and less as one nears retirement. So, whether the pension benefit is valued and offset or divided by a QDRO should not imply that either approach is inequitable.

There are, of course, exemptions and advantages or disadvantages to valuing a pension versus a QDRO or similar order when governmental retirement plans are involved, such as the Florida Retirement System (FRS).

With regard to FRS benefits, the inequity created arises from the fact that a former spouse cannot be named as a beneficiary (surviving spouse) to the retirement benefit should the participant die before the non-participant spouse, assuming the divorce occurred before retirement. Survivor benefits are a continuation of the core retirement benefit, another myth that needs to be dispelled.

Often attorneys for the plan participant spouse will argue that survivor benefits were not negotiated in the settlement agreement, so why should they be addressed in a QDRO? First, if the participant spouse predeceases the former spouse, his or her share will be either forfeited to the plan or paid to a subsequent spouse. Second, retirement plans are no different than savings accounts, except that retirement benefits and retirement accounts such as IRAs can only be in one person's name. The crux of retirement plans in the United States is that they are deferred income, income that otherwise would have gone into the family household but instead was diverted to an account for the employee. To not allow for survivor benefits is, in effect, awarding a possible subsequent spouse of the participant with benefits that accrued during the prior marriage, since the survivor benefit is a continuation of the core retirement benefit.

With the FRS, and under a FRS QDRO, a non-participant spouse's benefit is not secure, and a valuation of the benefit offset against other marital assets tends to be a more equitable option. If the value of an FRS pension benefit is offset in a divorce, it can be advantageous to both parties. The participant offsets the spouse's share with a discounted value, and the former spouse avoids the risk of losing his or her share.

With regard to valuation approaches, there are two that pertain to defined benefit plans: an economic based valuation and an actuarial based valuation. An actuarial based valuation determines the cost or liability of the plan to the company, while an economic based valuation determines the value to the parties. The economic approach is sometimes referred to as the life expectancy approach. What is not often disclosed, however, is that the valuation, or factors used, project the life expectancy to 110 years old with varying discounts for mortality along the way. There is not really anything wrong with this approach when put into

perspective. It is something that has to be done to ensure that there is enough in the plan to fund the benefit or to ensure that the plan is not under funded.

The economic based valuation, although *statistical* life expectancies are used, provides an equivalent amount necessary for the non-participant spouse to fund his or her own monthly benefit if he or she instead receives cash or equivalent assets. The economic approach can also adjust the life expectancies to account for family health history or an individual who may have a chronic debilitating condition or a terminal illness. Pension valuation programs or factors used in a table will not be able to account for this, nor will those using an actuarial approach who are not actuaries.

Whether assuming a very long payout period with discounts for the probability of death every year (actuarial approach) or basing the value on statistical life expectancies with a pre-retirement mortality discount (economic approach), either approach will tend to be very close in estimating the lump-sum present value. It should be kept in mind that the concept of present value, and the concept of value itself, is derived from economics, not actuarial science. If factors in a table are used, one must examine the underlying assumptions used to arrive at those factors. Therefore, an attorney relying on a valuation should ask how the present value was derived.

Interest rates, or more appropriately discount rates, are one of the most influential assumptions used in a pension valuation. This assumption alone can cause a difference in tens of thousands of dollars. The industry (of valuing pensions) has come a long way in terms of uniformity. The only viable rate guaranteed to span long periods of time is the U.S. Government bond rates, or one derived from such rates, such as a blended government bond rate. A valuation that uses anything other than long-term government bond rates should be cause for concern and call into question the validity of the valuation.

Lastly, the assumed retirement age is often used incorrectly in valuations. When benefits commence, and whether a monthly benefit is based on a normal retirement age or early retirement age, depends on the alternative. The alternative is if the plan benefits, instead of being valued, were divided by way of a QDRO or similar order, and when the non-participant spouse could receive his or her share. With governmental retirement plans, it is suggested that the normal retirement age should be used when valuing a pension because nearly all governmental retirement plans allow an alternate payee spouse to commence benefits only when the participant spouse does. That is, in governmental retirement plans, the participant controls the release of benefits. Now, if the plan in question is a private industry plan, the earliest retirement age is an appropriate age to use in a valuation, if made available. The earliest retirement age with private non-governmental plans is typically when an alternate payee can commence his or her share in a QDRO. Also, a reduction in the monthly benefit for early retirement is not a penalty by any means, as stated in the *Boyett v. Boyett* case. It merely suggests that if benefits are to be paid earlier than the normal retirement age, the benefit must be adjusted to account for the longer anticipated payout period. Often the lump-sum present value based on the earliest retirement age can be larger than the present value based on a normal retirement age, since there is less of a discount for time and less of a discount for mortality.

While there is case law to support the issues addressed in this article, keep in mind that every case can be different depending upon the circumstances. Every retirement plan has its own terms and conditions, and not all plans accept court order division of benefits. Therefore, the circumstances of each case or specifics about the retirement plan may affect the valuation or whether a QDRO or similar order is more suitable.

***Timothy C. Voit*** *is a financial analyst and author of Retirement Plans & QDROs in Divorce, published by CCH Incorporated. Mr. Voit has been admitted as an expert in both state and federal courts and has worked with law firms around the country to value and equitably divide QDRO retirement benefits for both private and governmental retirement plans. For questions regarding this article or QDRO questions in general, Mr. Voit can be reached at 1-800-557-8648, www.vecon.com or vecon@comcast.net.*

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(NOT in conjunction with The Florida Bar meetings, September 14 -16)

**Location: Delray Beach Marriott**

**September 8**

| | |
|---|---|
| 9:00 a.m. to 5:00 p.m. | Committee Meetings |
| 5:00 p.m. to 7:00 p.m. | Section Membership Reception |

**September 9**

| | |
|---|---|
| 9:00 a.m. | Meeting of the Executive Council |

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# What is a value?

## *Valuing various retirement plans and stock options*

**by Jeffrey A. Schneider, Royal Palm Beach**

J. SCHNEIDER

In the course of putting together the financial picture for the individuals involved in a divorce, many items are considered: bank, stock and investment accounts; personal or vacation homes; and personal effects, to name a few. Valuing liquid assets is generally straightforward. Cash holdings and the values of investments are reported on periodic statements provided by the financial institution or local newspapers. Real estate can be readily appraised, as can such items as jewelry, art, etc.

Other items that are listed in F.S. Section 61.076(1), which provides that "all vested and non-vested benefits, rights, and funds accrued during the marriage in retirement, pension, profit-sharing annuity, deferred compensation and insurance plans and programs are marital assets subject to equitable distribution," have to be considered. In addition, F.S. Section 61.075(3) "requires specific written findings of fact as to identification of marital and non-marital assets and as to the value and allocation of marital assets".[1]

The job of a certified divorce financial analyst© (CDFA)[2] is to examine the financial issues of divorce and provide clients and their advisors with powerful data to support the decisions contemplated. In addition to calculating and analyzing data, CDFAs use experts in specific fields such as real estate appraisers, business valuation experts, actuaries, etc., to properly ascertain true values. A CDFA uses this information and facts from other published sources to provide the necessary data to support a case.

Two of the most difficult assets to value are businesses and retirement/deferred compensation plans. This article will focus on the latter.

**Defined contribution plans**

As indicated previously, retirement and pension plans, individual retirement arrangements (IRAs), Keoghs and annuities, etc., are subject to the equitable distribution statutes. Defined contribution plans or qualified plans, such as the 401k, and other nonqualified plans, such as IRAs, are easier to value by simply looking at the end-of-period statements provided by the trustee. Other than for IRAs, a qualified domestic relations order (QDRO)[3] is the mechanism by which the nonparticipating spouse can receive any portion of the other spouse's vested interest in the plan. As an employer sponsored plan, the vested interest in a 401k or 403b plan is determined by and indicated in the actual plan documents.

There are three types of vesting in a deferred contribution plan. One is where the employer does not make any contributions to the plan. In other words, the value in the plan is the employee's contributions plus any earned appreciation. As such, the employee is 100 percent vested in that plan, and the plan's value is considered a marital asset if the employee was married when the contributions were made. This article will discuss later what happens when part of the contributions were made prior to the marriage.

Conversely, the employer can make 100 percent of the contributions. The plan usually calls for a vesting schedule, which specifically dictates how much of the plan's value the employee can take when employment is terminated, whether voluntarily or involuntarily. For example, after five years the employee is 70 percent vested, and the value is $100,000. Based on the employer's vesting schedule as indicated in the plan, $70,000 is considered owned by the employee. The amount that is marital property is the amount earned during the marriage.

Lastly, if the employer matches some or all of the employee's contribution, then a portion of the amount contributed by the employer and 100 percent of the employee's contribution is marital property. Again, the amount that is marital property is the amount earned during the marriage.

Any monies taken by the participating spouse is taxable income. If the recipient is under age 59½, the monies received can also be subject to a 10-percent penalty.[4] However, in accordance with a QDRO, the nonparticipating spouse can receive a portion of the other spouse's vested interest without being subject to the penalty.[5]

As indicated previously, an IRA is not a qualified retirement plan. As such, a QDRO is not required to divide the IRA. The trustee may, however, require that a QDRO be submitted for approval. The taxability and penalty rules are the same for the IRA as well as any defined contribution plan.

**Deferred benefit plans**

The valuation of a pension, which is usually the right to receive monthly payments at a specified retirement age, payable until death, is generally more difficult. A pension is also called a defined benefit plan. Conceptually, the value of a pension earned during the marriage is the amount of money it would take to purchase a single premium annuity through a life insurance policy. There is no actual cash value today.

The courts have been divided when they have ruled on how to value a pension. In some cases, they have decided that the amount to be divided is that portion acquired, either after the marriage or in most states, before the marriage. When a CDFA calculates the value of a pension, the specifics of the employee's

plan must be determined.

There are generally three methods in valuing a pension plan. The first is the "present value" or "cash-out" method. This method provides for a lump-sum payment to the nonparticipating spouse or another marital asset of equal value. As such, the participating spouse keeps the pension. The value is determined at the time of the divorce.

The second method is the "deferred division" or "future share" method. This method is used when no present value is determined. Each spouse is awarded a share of the benefits if and when they are paid. A drawback to this method is that the participating spouse can delay the retirement date to postpone the date when the ex-spouse can begin receiving any benefits.

The third method is called the "reserved jurisdiction" method. This is a last resort, because the courts retain authority to determine when any distributions from the pension plan are to begin, leaving both parties in limbo.

In determining the value under the first method, you apply a present value calculation on the future value of the participating spouse's distribution. For example, Jim (age 40) can receive $2,000/month (based on today's value) at his retirement age (65) in 25 years. This present value is used in dividing the pension as a marital asset.

In determining the value under the second method, you apply the percentage. Let us assume that Jim and Beth are married and 100 percent of Jim's pension was earned during the marriage. Using the example in the previous paragraph, Beth can receive $1,000/month as stipulated in a QDRO. However, since pensions are based on earnings, length of service and future appreciation, Jim's actual benefit may be greater than the $2,000. However, since the QDRO stated that Beth receives only $1,000, she will not be entitled to any increase.

It is important to ascertain whether the $2,000 is based on today's earnings and time spent with the company or if it is based on an assumption that Jim will stay with the company until retirement and includes projected earnings (including raises, bonuses and cost of living increases, etc.).

Another factor in valuing a pension is when a part of the pension was earned before the marriage. This is referred to as the "Coveture Fraction." The fraction states that the nonparticipating spouse receives a portion of the pension and is illustrated as

**Pension Value[6] x (50% x "The Coveture Fraction").[7]**

In computing the present value of a pension plan or future stream of income, one must use an interest factor, which has an adverse relationship to the present value. The higher the interest rate used, the lower the value. Conversely, the lower the interest factor, the higher the present value. The national standard for computing the present value is provided by the Pension Benefit Guaranty Corporation, which provides the interest used in valuing a pension on a monthly basis. The rate, often called the "lump sum" rate, is often lower than the annuity rate. Using the lump sum rate tends to over-inflate the value of the pension.

Lastly, when figuring the value to be divided, survivor benefits must be considered. If the participating spouse were to die prematurely, the ex-spouse would not receive all the monies expected. The survivor benefits tend to lower the ultimate benefit and must be included in its valuation.

In continuing with our divorcing couple, Jim and Beth, one must contemplate if Beth can begin receiving her portion of the benefits at Jim's "normal" retirement age (say age 65) even if Jim delays his actual retirement. The QDRO must state this situation, and the plan must provide for it.

**Public and military pension plans**

One caveat to the above discussion relates to public employees. The defined benefit plan for these civil servants generally will not allow a division by order of a QDRO, and in some states (e.g., Florida), the benefits are not assignable to the nonparticipat-

*continued, next page*


# Requests for admission re pension values

**by Joe Hood, Tampa**

Most of the well known calculational software will calculate present values of retirements. Where the anticipated retirement amount is known, I like to run a present value calculation and then attach it to a request for admissions pursuant to Fla. Fam. L.R.P 12.370 and Fla. R. Civ. P. 1.370. They are served without leave of court, and they can be served with the initial process or after service. If served with the initial process, the party has 45 days to answer or object. Failure to answer or object results in the matter being deemed admitted. See. *Dept. of Revenue v. Folks*, 685 So.2d 56 (Fla. 2d DCA 1996). If the request for admissions is denied, the other party can seek fees and costs under Rule 1.380(c) if the party goes on and proves the matter at trial. The court is required to make the award unless it finds the request had previously been held objectionable, the admission was of no substantial importance or there was other good reason for failure to admit. In any event, it is tactically advantageous to quickly and efficiently resolve the valuation issue so you can decide whether it will be necessary to retain a pension valuation expert.

**What is a value?**
*from preceding page*

ing spouse. This precludes us from valuing the pension as if the nonparticipating spouse were to receive a portion of the government pension. As was mentioned earlier, the nonparticipating spouse can argue for a like amount in the form of cash or other asset(s).

Military pensions may be divided like a private pension. The Federal Uniform Services Former Spouses Protection Act applies retroactively in that it allows for a division in a marriage dissolution proceeding of military retirement benefits. In *Amciaux*,[8] *Cunningham*[9] and *Johnson*,[10] the courts have ruled that military retirement pay is an asset to be divided as marital property.

**Stock options**

Florida's equitable distribution statute provides that "Marital assets and liabilities include ... Assets acquired ... during the marriage" and "All vested and unvested benefits, rights, and funds accrued during the marriage in retirement, pension, profit-sharing, annuity, deferred compensation and insurance plans and programs." The Fifth, Fourth and First District courts of appeal have held that stock options, if marital, are subject to equitable distribution. It appears from a Second District opinion that options may be treated as marital assets, but that it is not in error to treat them as income to determine alimony and child support. How do we value these options for equitable distribution purposes? How do we determine their income value? To date, Florida case law does not provide us with definitive answers. In December 1999, the Second District decided in the *Seither* case, which involved a *pro se* litigant and had a poor record, that "it remains for another case with a better record for this court to further address the treatment of stock options in dissolution proceedings."

Before one can determine the value of stock options, we have to understand the two types of options. Briefly, statutory stock options are governed by stringent federal statutes. There are two types of statutory options: incentive stock options (ISOs) and employee stock option plans (ESOPs). If the guidelines are followed, favorable capital gains rates apply versus ordinary income tax rates.

The ISO is a plan whereby the employee receives an option to purchase the company's stock at a predetermined price. These options, unto themselves, cannot be transferred incident to a divorce. However, if the employee-spouse exercises the options, the underlying stock must first be purchased and then divided.

ESOPs are plans where the employee buys the company's stock via payroll deductions, usually at a discount. As with an ISO, these purchases, which are held in trust, cannot be transferred.

Non-statutory or unqualified stock options have few restrictions. As such, they do not qualify for favorable tax treatment. When the employee exercises the option at a gain, the gain is included in the employee's income, subject to various payroll taxes and included in the year-end W-2. These options can be transferred. When the non-employee spouse exercises the options, that spouse is liable for the appropriate income taxes.

In valuing options, the question as to their classification comes into view. Are they property, income or both?

Are vested options marital property? What about those that vest post-divorce?

If one considers a stock option as "deferred compensation," it would necessarily follow that any such option, if awarded for work performed during the marriage, would constitute a marital asset pursuant to F.S. Section 61.075, whether vested or not.

There is law in Florida to support the argument that options for future services are not subject to equitable distribution. In a majority of circumstances, these options are unvested. For instance, if the option contract states that the options are or will be awarded for future services and any or all of such services will occur after the marriage is over, the practitioner can look to cases regarding the equitable distribution of pensions for guidance. Florida's Supreme Court has held that post-dissolution contributions to a retirement plan are not subject to equitable distribution, and the First District Court of Appeal has stated that benefits not accrued during a marriage are not subject to equitable distribution. It is interesting to note that tax courts have found that an item "accrues" when all events occur that fix the amount and determine liability. If an option for future performance is for events that have yet to "accrue," how can the option be subject to equitable distribution?

In addition, when valuing non-qualified options, there is risk involved because options are unfunded. Therefore, there is a chance that the underlying stock may be bought or sold by the employer, because the company can be bought by another, go bankrupt or go through a corporate reorganization.

As we have seen in valuing pensions and deferred compensation plans, many outside influences can affect the outcome of the calculations. One must also remember to have a properly worded QDRO approved by the trustees and in place prior to the finalization of the divorce. Many questions must be answered and much information must be gathered before any such divisions of these assets are to be made.

***Jeffrey A. Schneider, EA, CDFA, QI,*** *is an enrolled agent specializing in tax and accounting for individuals and small businesses. In addition, he passed a series of tests and received the designation of certified divorce financial analyst. It is this training that Mr. Schneider uses in helping a party to a divorce understand the financial ramifications of a divorce. He is also a qualified intermediary for the purpose of facilitating Internal Revenue Code Section 1031, Tax Deferred Exchanges. Please see his website at www.florida divorceplanner.com or www.sfstaxacct.com.*

**Endnotes:**

1 *Crocket v. Crocket*, 708 So. 2d, 320 (FLA 1st DCA 1998)

2 CDFA is a designation bestowed on individuals by the Institute of Divorce Financial Analysts after adhering to specific requirements and maintaining their knowledge through continuing education.

3 As enacted by the Divorce Reform Act of 1988

4 There are exceptions to the 10-percent penalty, but that goes beyond the scope of this article.

5 If the monies are not rolled over into another retirement plan, they are subject to the income tax, but not the penalty under IRC Regulation 72(t)(2)(C). There are several tax consequences to the nonparticipating spouse receiving monies from the other spouse's retirement plan. That goes beyond the scope of this article. The mandatory withholdings rules, under the Unemployment Compensation of 1993, state that all monies taken out of non-IRA or SEPs are subject to a 20-percent withholding.

6 Some states value pensions on the date of the divorce without taking into account future considerations; these are often called "frozen coveture."

7 This percentage is the *number of years married while working* **divided by** *total number of years until retirement.*

8 *Amciaux* (1996) 6666, So 2d, 577

9 *Cunningham* (1993) 623 So 2d, 1243

10 *Johnson* (1992) 602 So 2d, 1348

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# Family Law Section Fall Retreat October 11-15, 2006 in Manchester, Vermont at The Equinox Resort

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Situated on 2,300 acres, between the Green and Taconic Mountains, The Equinox dates back more than 200 years. The property, now featuring 183 rooms and suites, is home of the historic Equinox Hotel, the 1769 Marsh Tavern, and the intimately luxurious Charles Orvis Inn. Able to accommodate groups large and small, The Equinox offers spectacular views, the comforts of an authentic New England village, the world-class Avanyu Spa, and choice amenities.

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- The Equinox has been the recipient of the AAA Four Diamond Award for 14 consecutive years.
- The Readers of *DEPARTURES magazine* rated The Equinox "the #1 Luxury Resort" in the Northeast
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# Spring Retreat in South Beach

Left: The Hotel on South Beach– a "prime" location for the Retreat.

Below: With perfect weather and a beautiful sunset, the Welcome Reception was enjoyed by all.

In the South Beach mood– Executive council member Jeff Weissman and his wife Jesse out-dance the belly dancer at Opa's.

There's always time for business... Tom Sasser and Melinda Gamot

***Dinner at WISH... Fabulous!***

Executive council member Patricia Alexander poses with her husband.

In good company, retreat sponsor David McElroy of Secure Discovery Solutions

## *Good food, good wine, great company!*

Right: Getting cozy at Prime One Twelve.

# The Family Law Section of The Florida Bar WANTS YOU!

Get a jump on next year by signing up for committee membership now, instead of waiting for the Family Law Section preference form in the mail. This is your way of expressing interest in becoming more involved in the section's business. If you have an area of particular interest, fill out the form on the next page and mark the committee or committees in which you would like to be an active participant. The section's work can be diversified and unpredictable, but most certainly rewarding. Success can only be achieved with total involvement of quality individuals like yourself.

The section's purpose is to promote the objectives of The Florida Bar by improving the administration of justice in the area of family law. This is accomplished through continuing legal education programs, conferences, retreats, reviewing existing and proposed legislation in the area of family law and the production of publications such as the quarterly newsletter (*The Commentator)* the electronic publication (*FAMSEG)* and the annual *Recent Decisions*.

Being an active committee member does NOT require a lot of time out of the office. Committees meet in person three times a year, should you not attend the retreats. Notices will be sent out prior to the meetings in order for you to make the appropriate travel and hotel arrangements. Please take note and mark these meetings on your calendar.

- **General Meeting in September**: The Family Law Section will NOT meet in conjunction with The Florida Bar's general meeting in Tampa. Instead we will meet on September 8 - 9 at the Delray Beach Marriott. The Family Law Section committee meetings will be on Friday, September 8, and the Executive Council will meet Saturday, September 9.
- **Midyear Meeting**: The second scheduled committee meeting date is Thursday morning, January 25, 2007, in conjunction with the 2007 Certification Review Course, January 26 - 27, 2007, at the Grand Floridian, Disney.
- **Annual Meeting**: The third committee meeting is June 20, 2007, at the World Center Marriott in Orlando.

All other meetings are held by conference call or on the Family Law Section's website. Section members who request to be placed on the selected committee/s via their preference forms are expected to attend all committees. If you cannot attend, you must notify your committee chair prior to the scheduled meeting.

Section activity within the committees and the Executive Council is to study and take action appropriate to those purposes subject to the bylaws of the section and the laws, rules of court, rules and policies of The Florida Bar:

- Continue to present high quality continuing legal education programs.
- Continue to review proposed and existing legislation for the benefit of the public and the legal profession.
- Continue to provide adequate communication through the section's website, the production of the newsletter for the benefit and education of section members and the members of the judiciary.
- Continue to seek ways to expand membership by encouraging affiliate membership through sponsorships.
- Assist the Supreme Court with implementation of a statewide family courts system.

Active committee work is the door to becoming a leader within the section by serving on the Executive Council. Your interest and participation are greatly needed.

**Say YES to section committee participation and help make a difference!**

*********

*Use the form on the next page to apply for committe membership*

# Say YES to Section Committee Participation!

Select the committee(s) you would like to join as a dedicated, active member.

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Enclosed is my request to participate as an active committee member:

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**Please return this form to:**

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The Florida Bar
651 East Jefferson Street
Tallahassee, FL 32399-2300

If you have any questions or concerns, contact Debby Beck, *dbeck@flabar.org*, or by phone, 850/561-5650.

# If I could do it all over again ... *Financial lessons learned from divorce*

**by Regina Bedoya, Juno Beach**

R. BEDOYA

The uniqueness inherent in every divorce case is often overshadowed by the presence of common elements. The laws that govern the process are the same within a certain jurisdiction. A significant number of cases involve issues of child custody, splitting of assets and income arrangements. Even the circumstances that led to the dissolution of the marriage tend to fall within a handful of "categories." However, for those getting divorced, their case is the only case. The decisions made during the divorce process significantly impact each party's future. It has often been said that couples have one chance to do it right. Although there are special circumstances that allow revisions to the original agreement, these are rare.

Poor planning prior to a divorce is one of the most common financial mistakes. Decisions that are made in a vengeful environment, or by spouses who fail to follow professional advice, could have devastating, long-term ramifications. One of the most significant challenges during this legal, financial and emotional process is remaining rational and practical. Rather than "Who gets what," the question should be "What makes the most sense?"

Some of the most common financial blunders in divorce can be avoided with proper planning and a desire to make the best of what is. This approach undoubtedly requires the willingness to put aside negative emotions and focus on the task at hand. The legal, financial and counseling professionals assisting during the divorce play an important role in facilitating a positive outcome. Their impact on the lives of their clients extends way beyond the term of the proceedings.

**Fair but not equal**

When it comes to splitting assets, most spouses want their fair share. In most cases, the husband wants the retirement assets while the wife wants the house. What many fail to recognize is that not all assets are equal. The tax implications[1] when selling certain assets can be significant. Other assets are real money pits. They could require a significant amount of funds to maintain. As expenses increase they are often not met by increasing income, causing a deterioration of the financial situation.

**The marital home**

Going from one household to two might require selling the family home and downsizing to a smaller one. The notion of "keeping up appearances" at the expense of a comfortable future must be carefully examined and the facts presented to the client. The presence of school-age children tends to exacerbate this issue. When the finances are limited, selling the house at the time of divorce could improve cash flow and free up dollars to be saved for the future. Ultimately, children tend to adjust to their new environment, and the reduced financial stress in the household makes up for the inconvenience of moving.

**The nest egg**

When retirement assets are to be divided between husband and wife, and as long as they are subject to rules set under the Employee Retirement Income Security Act (ERISA), a qualified domestic relations order (QDRO) is required. The plan sponsors will not divide the retirement accounts as indicated in the divorce decree unless the appropriate paperwork is provided. One of the most common mistakes regarding the splitting of qualified assets is the failure to get the proper paperwork in place. This causes delays that might lead to unnecessary aggravation. When proper documents are filed, the receiving spouse can take his or her share of the assets and roll it into another tax-deferred account without incurring penalties or income taxes on these funds.

**Protecting the income stream**

Another common mistake that could result from lack of planning is not protecting the alimony and/or child support payments through the use of a life insurance policy. In the event that the paying spouse dies prematurely, these payments will stop unless provisions have been made. It is advisable that a life insurance policy be obtained on the paying spouse prior to the divorce. The owner of the policy should be the receiving spouse in order to protect from unwanted changes of ownership and/or beneficiaries of the policy. The amount of insurance must be calculated to provide for the scheduled alimony and child support payments as well as anticipated future expenses (e.g., college tuition).

**Lifestyle decisions**

Most people must reduce their standard of living following a divorce. A detailed budget based on projected income and estimated expenses will facilitate adjusting to the new lifestyle. Special consideration must be given to protecting the family with adequate health insurance. In addition, if retirement dollars are not sufficient to ensure a comfortable retirement, a portion of the income must be saved for the future.

**In summary ...**

While the emotional and financial costs of a divorce are undisputed, they can be mitigated by proper wealth management. As professional advisors to our clients, we seek to empower them with the knowledge they need to make good decisions. We also add value to their

lives by encouraging them to take the necessary steps that will reduce areas of vulnerability and increase their options and choices for the future.

***Regina Bedoya*** *is president and CEO of RB Financial Advisors Inc. She is a financial advisor with Securian Financial Services Inc. and advises clients throughout South Florida. Call 561/691-6800 for more information. Investments and financial planning service are provided through Securian Financial Services Inc. Member NASD\SIPC.*

**Endnotes:**

1 This information is a general discussion of the relevant federal tax laws. It is not intended for, nor can it be used by, any taxpayer for the purpose of avoiding federal tax penalties. This information is provided to support the promotion or marketing ideas that may benefit a taxpayer. Taxpayers should seek the advice of their own tax and legal advisors regarding any tax and legal issues applicable to their specific circumstances.

# Anatomy of commingled funds: Untying the knots with new theory

by Jerry Reiss, Ft. Lauderdale

Assets are considered *commingled* when a single asset or a single account contains marital and non-marital portions. When the marital and non-marital portions are just money, they are indistinguishable from each other. We use the term *fungible* to describe this. *Tracing* is an unbiased method used for demonstrating where funds went. We often consider showing that the assets have distinct characteristics as synonymous with tracing. While often true, it is not always and so leads to confusion. If one can show that the marital and non-marital portions have separate characteristics, then one can successfully trace where the non-marital funds were at all times. This is generally sufficient as proof that a gift was not intended.[1] Reasoning that if a statement is true, its contra positive is also true, some courts have held that if the funds cannot be traced, then there must have been intent to gift those funds.[2] There are two problems with this conclusion. The most obvious is that the courts accept other forms of proof.[3] Thus, while tracing is sufficient to overcome a presumption of a gift, it is not necessary. This by itself invalidates negating and reversing the order of the statement as a true contra positive. It also ignores the original theory that commingling funds inside a joint account creates the presumption of an interspousal gift.[4]

A presumption of a gift is created only when the title of the non-marital asset changes to include the names of either spouse or when non-marital funds are deposited to a jointly titled account.[5] We can sometimes show where the non-marital funds were at all times without demonstrating separate characteristics.[6] We can do this even with fungible non-marital and marital assets combined inside a joint account.[7] We can trace funds that are fungible when they are deposited to a joint account and the exact amount of money is withdrawn only days later and used to purchase a non-marital asset or to pay for a non-marital liability[8]. When this occurs it is clear where the non-marital funds were at all times. Thus, it is important to understand that when the marital and non-marital funds are indistinguishable from each other, they will often be untraceable; but this is not always so. The Fifth and Fourth District Courts of Appeal have confused fungible assets with untraceable assets when they attempted to separate actively earned funds from their passive component. This led to incorrect rulings that any marital effort that results in appreciation converts the entire appreciation of the non-marital asset into marital property.[9] These courts have only recently understood that this is incorrect.[10] This article will show that other district courts are extending this same confusion to traceability of assets and whether an interspousal gift applies to the transaction.[11]

## Creating an interspousal gift

A line of cases has determined that when non-marital funds are either deposited to a joint account or retitled to include the other spouse's name that the transaction creates a presumption of an interspousal gift.[12] This presumption may be overcome by showing that a gift was not intended.[13] One of the ways to prove this is to demonstrate that the commingled non-marital portion can be traced from the date it was mixed with marital funds.[14] Yet tracing is a word of art used in many different contexts in family law. When it is used for describing the requisite proof for showing that no gift was intended when liquid funds are commingled, it often means that one must show that the traced portion has distinguishing characteristics from the other portion.[15] Otherwise, since money is fungible, unless the distinguishing characteristics can be demonstrated, the marital portion has lost its separate character from the non-marital portion.[16] But this conclusion converts the non-marital funds into marital property only when the issue of a presumptive gift is raised as a result of the transaction.

A recent case decided by the Fifth District Court of Appeals has determined that titling alone does not cause a presumption of a gift.[17] It found that intent is not determined by changing the title of the non-marital asset alone, but is also determined by the actions that follow. This opinion is erroneous because the facts surrounding the intent are an element of whether the party seeking to show that gifting is not intended can prevail. The opinion embraces circular reasoning. Section 61.075(5)(a)(3), F.S., provides that marital property includes interspousal gifts of non-marital property. But, under what circumstances has a gift been created? Transactions are not labeled as gift or non-gift. A particular transaction can suggest a gift. When a spouse brings assets to the marriage that are kept separate, there is certainly an expressed intent to treat those assets as non-marital property. When the title of the separate assets is changed to include the other spouse and that spouse has equal control over that asset, the transaction implies a gift. This implication creates a presumption. The surrounding facts are then examined before concluding that a gift occurred. When one party offers unrebutted testimony that the transaction occurred for other than gifting purposes, that proof overcomes the presumption and the inquiry ends there. By interchanging the elements of the proof with what creates the presumption of a gift, as the Fifth DCA does with *Crouch*, an interspousal gift has been expanded to include commingled assets inside any account.[18] This includes assets that are titled solely in one name.[19]

It also includes assets owned by a trust. Both conclusions are incorrect and result from circular reasoning. To conclude otherwise, one must conclude that a deliberate attempt to convert marital property into non-marital property is a presumed intent to gift the non-marital property to the other spouse. Right!

**Section 61.075(7) defenses to Section 61.075(5)(a)(3)**

When non-marital funds are deposited to a joint account and maintained in the account for a very short period of time, this has been cited as acceptable proof that no gift was intended.[20] The courts reason that there was little time for earnings to accrue or any other expenses to be paid, thereby rendering the issue of commingling moot. Yet what difference does this make when the non-marital funds are inextricably commingled with marital funds? The liquid non-marital funds are fungible and, once deposited into marital funds, they become indistinguishable from each other. Once again, circular reasoning is employed to reach a correct result. The funds are traceable only as to intent, not whether the same funds are used to purchase the non-marital asset. The small amount of time limiting the amount of earnings has nothing to do with the Section 61.075(7) proof. If there is an intended purpose other than gifting, the funds likely will be moved fairly quickly. But the fact that they are moved quickly does not invalidate the proof. The fact that there is a deposit and a withdrawal of an identical amount of money proves a design and goal for that exact amount of money apart from gifting.[21] Naturally, the offered proof is questionable if the money sits in the account for a very long period of time. The amount of time that is reasonable for the transaction is linked to the contemplated investment and the reason for the delay and not to any earnings or investments made in the interim period.

**Effect of commingling funds when gifting is not intended**

If no presumption of gifting is raised, then the party seeking a classification of the original property as non-marital still has a burden to demonstrate a non-marital portion.[22] To satisfy this latter burden, the court routinely accepts any reasonable method, and it does not require tracing the non-marital funds.[23] Yet the case law emerging over the past few years shows the confusion between the two burdens. This led the Fourth District Court of Appeals to first conclude that the infusion of marital effort or funds into a non-marital closely held business transmuted all of the appreciation of the company stock into marital property.[24] When challenged with an ability to separate active and passive efforts in *O'Neill*, the Fourth District receded from this line of cases.[25] Yet most trial courts of Florida's east coast as well as those situated in the First, Third and Fourth District Courts of Appeals continue to apply a perceived inability to separate the two forms of appreciation with a non-marital house. This is why they follow the formula set forth in *Landay v. Landay*, 492 So.2d 1197, 1198 (Fla. 1983)[26], which allocates most of the appreciation in the home to the marital years even though its contribution is minimal.[27] Accordingly, it is possible to calculate a marital and non-marital component even when it is impossible to separate the non-marital portion and its passive component by demonstrating that each has separate characteristics.

Other cases have determined that when marital and non-marital funds are combined, unless the original funds can be traced (with separate characteristics), they are indistinguishable from the marital funds.[28] This conclusion is obvious and does not merit discussion. However, error occurs when the same courts go further to conclude that it is therefore impossible to determine from which of the two ledger accounts expenses are paid or earnings accrue, and therefore the party seeking to demonstrate a non-marital portion cannot prevail. Applying this incorrect reasoning to a family run business led to the *Robbie* conclusion. The Fourth DCA only recently receded when challenged in *O'Neill*. One thing is certain, however. Regardless of the motivation for combining the funds, the physical act of combining them is presumed intentional, yet it is a stretch in logic to conclude that interspousal gifting is the spouse's motivation for doing it.

The trial courts and the experts who testify before them mix up the two distinct burdens, and this has led to the confusion. In fact, this confusion is so prevalent that CPAs often attempt to separate marital and non-marital components of defined contribution plans by tracing the non-marital investments from the date when the parties married (as a means for determining a non-marital portion). This is absolute nonsense because the whole point behind tracing is to do so when the spouse who owned the account had the ability to combine the funds. Such is not the case with most corporate retirement plans. The assets of the account are owned by the trust, and only the company appointed plan administrator (designated in the pension trust) can make these decisions. Yet regardless of the motivation for doing it, the effect is the same: It creates a new asset from which the individual and the marriage have a stake. It does not show an intended gift any more than using marital funds to pay the mortgage of a non-marital house does. We do not inspect the non-marital house to see for what portion of the structure the marital funds paid.

The appellate opinions do not grasp the concept of a single fungible asset that preserves marital and non-marital components. They certainly would understand the concept better if they attempted to reconcile how mutual funds can separate millions of shareholder interests accurately when the fund is a fungible composite of many different investments. They certainly would begin to understand the concept when they are routinely provided testimony separating fungible assets of a defined contribution trust. Retirement assets are fungible assets that preserve non-marital portions without a requirement to trace them. The retirement trust

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owns both portions. Thus, when the *O'Neill* court concluded that it lacked evidence to determine whether the trial court abused its discretion in finding that the retirement assets were actively managed, it failed to apply the law to a single fungible asset, the retirement plan. How could any trial court find that a retirement asset is actively managed when it cannot determine whether the effort it rules is active is applied to the marital portion of the asset or the non-marital portion? The trial court by making that finding contemplates two distinct assets when there is only one. As one asset, both components appreciate by the same percentage. As two separate and distinct assets, each portion increases by its investments. In other words, each portion has separate characteristics. This is not possible when the trust owns the assets, and the employee only has rights to benefits from the trust.

Yet the concept of one fungible asset with two distinct portions is not unique to liquid funds. Creating one asset with two portions also happens when marital funds pay down the mortgage of a non-marital house. It also occurs with a non-marital business in which the owner adds marital property. Gifting is never raised as an issue with these assets unless the titling of the asset changes. Why then is it raised in the context of funds?

The reasoning in the reported decisions appears to be that different funds are indistinguishable from each other and are "fungible." Yet in the above examples, one cannot partition a house or business into two separate components with distinguishing characteristics, and retirement plans involve the same kind of "fungible" funds with bank accounts and liquid securities. If the intent of depositing marital funds into a non-marital account is to make the two sources of funds work as one, when the owner of the non-marital portion expends funds from this mix each expense involves a payment from each component in the same way that marital and non-marital ledger allocations increase by the same percentage of appreciation inside a retirement plan. This is the practical effect of what is intended when the funds are mistakenly combined. This is especially true when the party who deposits the paycheck into the non-marital account mistakenly believes that these funds are his or her separate property. The erroneous conclusion is only a mistake as to how marital law applies. The only intent that can be inferred from this mistake is to treat the two assets as *one* fund and not two. It is a great leap in logic to conclude that this action contemplates a presumption of gift. Accordingly, the reasoning of the case law that the party cannot demonstrate the portion from which the funds were expended misses the entire point that combining the funds was intentional. While this same principle is at work when funds are combined inside a joint account, the difference is that a presumed gift occurs when a party changes the titling on the non-marital account to include both names. The significance that traceability has when this occurs is only that if combining two distinct assets was not intended, steps would have been taken to keep the non-marital source separate from the marital. While most fail to keep the funds separate because they fail to understand the impact of combining the funds, the controlling point is that the party who made these decisions has the burden to demonstrate the contrary intent when those actions imply a gift, not when they do not.

To better understand why intent to combine the two inside a separately titled account does not destroy the non-marital portion, we need to ask ourselves certain questions about the resulting marital and non-marital portions if the moneys had not been combined. Certainly marital expenses can be paid with non-marital funds. This is easily accomplished when the funds expended come from a separately titled account that existed before the marriage commenced. Similarly, marital funds can be used to pay non-marital expenses without a court finding that party dissipated marital assets. Since both are clearly possible, it is certainly possible to pay part of the marital expenses with marital funds and the balance with non-marital funds.

**The significance attached to intentionally combining funds**

In each of the above contrasting examples, the owner of the asset either lacked ability to keep the portions separate, or it was very impractical to do so. The owner of the business would have to hire an unrelated party to run the business and would have to give up daily control of its operations. This would either invite theft from the business income or require the sale of the business to

prevent this. The owner of the house would need separate non-marital funds to pay the mortgage during the marriage. This is because one cannot partition the structure of the house between marital and non-marital ownership. A requirement to pay the mortgage with non-marital funds is the same as requiring that the house be unencumbered when entering the marriage. This would require a separate source of funds from which upkeep and taxes are paid during the marriage. The participant of a retirement plan does not even own the investments made before the marriage begins; the trust that sponsors the plan does. Thus, when funds are intentionally combined outside a retirement plan structure (and did not have to be), that person loses the right to claim that the non-marital portion *works* as a separate asset. That does not translate into losing the non-marital portion of the combined asset any more than it does with a house, business or retirement plan. Therefore, when funds are intentionally combined into a separately titled account, the party who combined them loses the ability to claim that marital and non-marital expenses are paid exclusively from the infusion of the marital funds (although its value necessarily will be less). It pays them from the combined funds, and each payment contains a portion of each. As long as the transactions are limited to payment of marital expenses, there is no issue that a non-marital portion cannot be determined.

For example, if on the transactional date the marital funds represent 30 percent of the value of the two, the earnings that accrue are credited to both portions so that the marital portion is always 30 percent of the asset. This will continue in this fashion until new marital money is added. This is what happens with a retirement asset that contains marital and non-marital components. Adding new marital money would increase the percentage that is marital property determined by the values on the date that the addition is made. This is exactly the way the marital portion of the retirement benefit works. Disbursements that are used to pay marital expenses preserve the percentage that is marital after the disbursement is made. Complications may arise if the expenses paid are non-marital, because including a marital component in the payment raises possible issues of dissipation of marital assets if the other spouse did not know about or was powerless to stop it. This is curable when applicable by letting the non-marital portion bear the total expense even though the intent may have been to have the entire fund pay that portion from the two sources. The effect of combining the funds without retitling the non-marital portion is effectively the loss of the right to treat the non-marital portion as a separate asset. Loss of this right does not confer an interspousal gift of the non-marital money any differently than marital contributions added to a non-marital 401(k) benefit does. If, on the other hand, the intent was not to merge the two distinct assets into one, then that party may be required to trace the non-marital portion to show the contrary intent. If the party can show the contrary intent with convincing evidence, then marital expenses could be paid exclusively from the marital portion. The lesser marital portion could be determined with the dollar weighted method. This method treats the asset as one and preserves the portions as separate and allows the marital expense to be deducted from the marital share. It does this by weighting the accrued earnings or loss thereof with the duration of the dollar amount invested. Since intent is not an issue with each portion inside a defined contribution plan, this method (used by actuaries and investment firms) is ideally suited to calculate a non-marital portion of these assets.

**Active effort rulings are inconsistent with commingling rulings**

It was shown above why the combining of marital and non-marital funds inside non-marital accounts does not convert the entire account into marital property. This conclusion can be further supported with the appellate rulings that examine when marital effort converts the appreciation of a non-marital asset into marital property.[29] Earlier rulings show that marital effort becomes active marital effort when one party challenges whether the appreciation is passive and the other party fails to show why it is passive. This conclusion by itself surely leads to the commingling of marital and non-marital assets: The non-marital component before commingling is the original asset. The marital component is created with the appreciation that results from actively managing the non-marital asset. When the owner of the original asset cannot demonstrate a portion of the earnings that is passive appreciation, this failure makes the entire appreciation marital property.[30] Yet this conclusion does not destroy the non-marital portion, only the non-marital portion of appreciation on the non-marital asset.[31] This shows clearly that combining marital and non-marital assets inside a non-marital account still preserves the "principal" non-marital portion even though it is indistinguishable from the marital portion because it fails to have separate characteristics. This further shows that commingling funds absent a gifting presumption can never reduce the original non-marital portion, which is principal. To the extent that some money was expended, the non-marital portion could never be less than the original principal less the money expended.

Recent opinions have acknowledged that appreciation resulting from active effort can contain a non-marital component classified as passive income.[32] Both active and passive appreciation components are reinvested and accumulate more earnings. They are indistinguishable from each other and the original principal by their characteristics, because money is fungible. They are inextricably commingled with each other to the extent that there is more than one investment purchased, causing the effort to be active management. It is impossible to keep the passive component of the earnings separate from the active component

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**Commingled funds**
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because these components are the product of market conditions and cannot be known until after the results are analyzed.[33] The problem that one cannot distinguish reinvested income between its passive (non-marital) and active (marital) components does not cause the fund to lose its separate non-marital character. If it did, then earlier conclusions that any marital effort on investing the non-marital asset, no matter how small, converts the entire appreciation of the non-marital asset into marital property are correct. The Fourth DCA, which had been the only remaining DCA to support this theory, recently receded from it in *O'Neill* and *Chapman*. Finally, even if the earlier rulings had been correct, the fact that reinvested income is inextricably commingled with the original asset never led to the conclusion that the entire asset is marital. Why then has that reasoning been applied to certain commingling rulings to reach this result?

**Creating an interspousal gift**

As previously discussed, a gift is created when one establishes a presumption of a gift and fails to demonstrate contrary intent.[34] It is also created when an asset is borne from a marital debt. This occurs as a result of the equitable distribution statute.[35] If the party claiming that the asset is non-marital property can show that the loan was created solely by pledging a non-marital asset as security for the loan, then the asset is non-marital property because the asset was created with essentially non-marital funds.[36] But there is an important exception to this. When the loan is created with joint spousal liability, then the asset (equal to the loan amount) that began as non-marital property is automatically converted to a marital asset irrespective of whether the lender had a lien against a non-marital asset before granting the loan. This result occurs because, if the value of the asset as security goes south, the other spouse has a potential liability from that loan. This is an important exception to the *Farrior* ruling, which held that a margin account created solely from non-marital stock does not result in the commingling of assets with the margin loan created during the marriage.[37] If the asset is later sold to produce a profit, the entire asset is marital property. Thus, when refinancing the non-marital home is repaid from the sale of the asset, the marriage has a stake in the non-marital house equal to its repayment and any passive appreciation that accrues on that repayment to the date of divorce. When the parties refinance a non-marital house many times, the equity may become mostly marital property when the parties divorce even though the house is titled in only one name.

**Conclusion**

Funds are commingled when marital and non-marital moneys are combined. Two separate portions are identifiable with other non-marital assets even when they cannot be separated by distinguishing characteristics. A presumption of gifting occurs only when the title of the non-marital portion changes. The combining of funds involves this same principle. It is reasonable to presume an intended gift when one changes the title of the asset to include the other spouse. That transaction gives the other spouse control over the asset. Whether or not the other spouse exercised control is only an element of the proof of whether a gift was intended. It is not reasonable to assume an intended gift when one commingles funds inside a non-marital account. When this is done, it is because the party erroneously believes that it is his or her separate property. While it is unreasonable to presume an intended gift, it is very reasonable to presume intent to consolidate the two accounts as one. The party loses the ability to treat the combined asset as two separate funds unless he or she can prove contrary intent. This no more makes that asset marital property than paying down the mortgage of a non-marital house does. Unlike a non-marital house where the party paying down the mortgage has no choice in consolidating the

portions, when the individual does this it translates into losing the right to exclusively deduct marital expenses from the marital portion of the fund that pays the marital share. This would be similar to a party making improvements to the non-marital home using marital and non-marital cash. Since the intent of consolidation is to make the two funds operate as one, marital expenses must be deducted from both shares just as the previously mentioned contribution enhances both portions of a house.

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**Endnotes:**

1 *Williams v. Williams,* 686 So.2d 805, 808 (Fla. 4th DCA 1997)
2 *Adkins. v. Adkins,* 650 S.2d 61. 66 (Fla. 3rd DCA 1995)
3 *O'Neil v. Drummond,* 824 So.2d 1032, 1034 (Fla. 1st DCA 2002); *Heinrich v. Heinrich*, 609 So.2d 94, 95 (Fla. 3rd 1992)
4 *Amato v. Amato,* 596 So.2d 1243, 1245 (Fla.4th DCA 1992); *Archer v. Archer,* 712 So.2d 1198, 1199(Fla. 5th DCA 1998)
5 *Id.*
6 *Crouch v. Crouch,* 898 SO.2D 177, 182-183 (Fla. 5th DCA 2005)
*7 O'Neil v. Drummond,* supra
8 *Id.*
9 *Rutland v. Rutland,* 652 So.2d 404 (Fla. 5th DCA 1995); *Pagano v. Pagano,* 665 So.2d 370 (Fla. 4th DCA 1996)
10 *Anson v. Anson*, 772 So.2d 52, 55 (Fla. 5th DCA 2000); *O'Neill v. O'Neill*, 868 So.2d 3, 4-5, (Fla. 4th DCA 2004); *Chapman v. Chapman*, 866 So.2d 118, 119 (Fla. 4th DCA 2004)
11 *Crouch v. Crouch*, supra; *Steiner v. Steiner,* 746 So.2d 1149, 1150 (Fla. 2nd 1999)
12 *Amato; Williams; Spielberger v. Spielberger,* 712 So.2d 835, 837 (Fla. 4th 1998)
*13 Lyons v. Lyons,* 681 So.2d 837 (Fla. 2nd 1996)
*14 Williams; Archer*
*15 Id.*
*16 Lyons*
*17 Crouch*
*18 Steiner,* supra, and *Adkins,* supra, employ the same reasoning.
*19 Id.*
20 *O'Neil v. Drummond,* supra
21 *Id.*
22 *Jahnke v. Jahnke,* 804 So.2d 513, 517 (Fla. 3rd DCA 2001)
23 *Gregg v. Gregg,* 474 So.2d 262 (Fla. 3rd DCA); *Anson v. Anson,* 772 So.2d 52, 55 (Fla. 5th DCA); *Trant v. Trant,* 545 So.2d 428, 429 (Fla. 2nd DCA 1989)
*24 Robbie v. Robbie,* 654 So.2d 616 (Fla. 4th DCA 1995); *Pagano v. Pagano,* 665 So.2d 370 (Fla. 4th DCA 1996)
25 In *Chapman,* the court clarified its position in *Pagano* as fact intensive and not the result that the ruling concluded that it is impossible to separate passive from active appreciation. Yet this conclusion fails to reconcile this with what the same court meant in the earlier 1995 *Robbie* opinion. *Robbie* concluded that the trial court was free to divide the property unequally on account of the inability to separate the appreciation between its marital and non-marital values.
26 Another reason is failure to understand that interest payments are not active improvements to the property. This can easily be explained by the following: It is not reasonable to expect to find rent offered on a comparable house to be less than the full mortgage payment. Thus, the marriage receives offsetting enrichment by the value of the rent it would have to pay for a similar house. Accordingly, only the pay down of principal creates a marital component. This likely is the reasoning employed by the Second DCA in arriving at the same conclusion in *Straley v. Frank,* 612 So.2d 610, 611 (Fla. 2nd DCA 1992).
27 Compare *Gregg; Stefanowitz v. Stefanowitz,* 586 So.2d 460, 462 (Fla. 1st DCA 1991); *Reich v. Reich,* 652 So.2d 1200, 1202 (Fla. 4th DCA 1995) to *Straley v. Frank,* supra.
*28 Steiner*; *Adkins*
29 *Adkins; O'Neill*
*30 O'Neill @* P. 5
31 *Id.*; *Young*
32 *O'Neill*; *Yitzhari v. Yitzhari,* 906 So.2d 1250, 1254 (Fla. 3rd 2005)
33 One separates the two by questioning what could be earned in the open market without effort, i.e., by turning over the decision making process entirely to a broker. Performance averages could be established using certain indexes like the S&P 500. All earnings below that level are passive appreciation irrespective of the amount of effort because they resulted from market conditions. Only those above that benchmark are the result of the effort and are marital. The average used in the process is determined after the investments are made, and therefore the passive component could never be segregated.
34 *See* 61.075(7) F.S.
35 *See* 61.075(5)(a)(1) F.S.
36 See 61.075(5)(b)(1) F.S.; Also see *Farrior v. Farrior*, 736 So.2d 1177, 1178 (Fla. 1999)
37 *Id.*

***Owen v. Owen,***
867 So. 2d 1222 (Fla. 5th DCA 2004)
Reversed imputation of income with directions to reduce by 50%.

***Atkins v. Atkins,***
611 So. 2d 520 (Fla. 1st DCA 1992)
Reversed inadequate permanent alimony award.

***McAvoy v. McAvoy,***
662 So. 2d 744 (Fla. 5th DCA 1995)
Reversed lump sum distribution award without a payment schedule.

***Pettry v. Pettry,***
768 So. 2d 8 (Fla. 5th DCA 2000)
Reversed conversion of rehabilitative alimony to permanent alimony.

***Winn v. Winn,***
669 So. 2d 1155 (Fla. 5th DCA 1996)
Reversed "woefully inadequate" permanent alimony award.

***Hamlet v. Hamlet,***
583 So. 2d 654 (Fla. 1991).
Reinstated permanent alimony award.

***Stockstill v. Stockstill,***
770 So. 2d 191 (Fla. 5th DCA 2000)
Reversed due to trial court's extensive questioning.

***Vick v. Vick,***
675 So. 2d 714 (Fla. 5th DCA 1996)
Reversed for failure to consider business enhancement.

***Pettry v. Pettry,***
706 So. 2d 107 (Fla. 5th DCA 1998)
Reversed modification judgment due to denial of due process.

***Mowe v. Mowe,***
734 So. 2d 602 (Fla. 1st DCA 1999)
Reversed attorney fee denial despite significant property distribution.

***Rykiel v. Rykiel,***
795 So. 2d 90 (Fla. 5th DCA 2000)
Reversed dissolution judgment due to excessive awards against husband.

***Layeni v. Layeni,***
843 So. 2d 295 (Fla. 5th DCA 2003)
Reversed denial of wife's interest in medical accounts receivable.



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