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FAMILY LAW ACCOUNTING NEWS

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First off, to those of you who stopped by my table at the **2017 Family Law Institute**, thank you very much. Congratulations to the two winners of the messenger bag raffle: Kathleen Stillman and A. Thomas Smith.

I thought that I would use this issue of my newsletter to revisit the concept of "The Double Dip". The double dip is most considered when addressing maintenance/support in conjunction with a business valuations. However, the concept can include not only business valuations but also stock options and defined benefit plans when considered in conjunction with maintenance/support.

Delving Into the Double Dip

What is the Double Dip:

The theory of the double dip comes into play when the argument is made that the same dollars are being counted twice; both as part of the property division and included in income of one (or both) of the parties. One of the most often discussed combinations is the goodwill of a business and income of the business-owning spouse. Many valuation methods are based on the income of the business; either past, future projections or a combination of both. Of course income is also an extremely important component in determining maintenance/support. The contention of the double dip arises when the spouse who controls the business argues that the same stream of income is being used both in determining value of the business as well as determining maintenance/support or other required payments……..hence the "double dip" argument. There are numerous opinions as to why the double dip should or should not be considered.

Double Dip and the Business:

"…it was based on the wife's need and 'a method to reach a fair and equitable distribution of assets and liabilities.'"

In Re Marriage of Kirkendoll (2016 Wash. App Lexis 2357) – In this case, the husband argued that the double dip occurred when it awarded him the business as well as ordering him to make other mandatory payments from his income. Husband's expert valued the business between $100,000 and $200,000, of which all was considered goodwill. Wife's expert claimed the business was between $100,000 and $1,200,000 (no explanation was given for the large range of value). The Court awarded wife $274,000 in assets and husband between $300,000 and $1,400,000 in assets. The Court also found husband's income was $12,400 and wife's income was $3,000. Long term maintenance of $3,000 per month was ordered. The Court stated "…it was based on the wife's need and 'a method to reach a fair and equitable distribution of assets and liabilities.'". In reading Kirkendoll, it appears that there were some financial related questions that the Appeals Court could not address because there wasn't any record made of the issues during the trial. This is just an important reminder to make sure that you address the issue and put on the record all of the relevant financial information related to the case..

"….without having to erode FFM's value."

In Re Marriage of Cheng (2016 Wash. App Lexis 2854) – So the State of Washington felt that the issue needed to be addressed again so here comes the Cheng case. In this case, husband (Victor) had a consulting business (FFM). Both spouses' experts used the capitalization of excess earnings method and PROJECTED future income for the business and the Court found that value of the business to be $3.6 million. The valuation did include a reasonable replacement compensation adjustment. Because there were not sufficient assets to provide wife (Julia) with her half of the value of the business, husband was ordered to pay an equalizing payment every month for 15 years at 6% interest (resulting in monthly payments of $12,279.42). In addition, husband was ordered to pay monthly spousal maintenance of $20,000 for eight months, $15,000 for the next 24 months and $10,000 for the next 12 months. "The Trial Court expressly rejected as a matter of law Victor's argument that awarding both maintenance and half of FFM's value to Julia provided Julia with a double recovery".

The Court of Appeals specifically addressed the double dip issue. Since the value of the business had a reasonable replacement compensation factor built in (which results in a lower value….in theory), husband would be able to pay spousal maintenance "….without having to erode FFM's value." The Court of Appeals then stated "Because FFM generates net profit from its operations for Victor to receive as income without decreasing its value, this case does not involve double recover for Julia." Simply stated; there is no way to simply explain this. The ultimate foundation for the ruling, in my opinion, is that the value of FFM was determined by hypothetically pulling the husband out of the business and paying a third party to run the business. Therefore the value of the business was based on a more passive ownership (the third party running the business, and husband receives only the excess profits) versus an active ownership (husband running the business and paying himself all of the profits). Had the Court of Appeals found that the maintenance amount forced the husband to actually draw out income from the business that would have diminished the value on an ongoing basis, then they would have had to consider the double dip issue.

“Trial courts may treat a spouse’s future business profits either as a marital asset subject to division, or as a stream of income for spousal support, but not both.”

In Re Marriage of Heller, 2008-Ohio-3296 – This Ohio case sees things a little differently. The original Trial Court ordered husband to pay wife one half of the value of the business plus a percentage of future distributions from the business as spousal support. Husband claimed “In other words, defendant argues that the court abused its discretion in reducing the future profits of a marital asset to present value and dividing that value equally between the parties, and then re-awarding part of defendant’s half of that asset to plaintiff by ordering payment of a percentage of those profits once they were actually realized.” Additionally, “Defendant argues that the court abused its discretion in basing additional spousal support on defendant’s income, inclusive of his share of future profits, when those profits had already been accounted for in valuing a marital asset (defendant’s interest in the company) and had already been equally divided between the parties.” The Court of Appeals found that there was an abuse of discretion in the decision made. This case has numerous explanations regarding the double dip concept. However it summarized the issues by stating “Plaintiff receives her share of the total value of the business immediately by a tax-free offsetting assignment of other, presently liquid assets, while defendant cannot immediately reap the benefit of H&S’s future earnings, and will be required to pay 20% of his share of the value one he receives it, even though plaintiff will have already received her share of this value. In ordering this result, the court “double dipped,” or awarded part of the same asset to plaintiff twice”. **“Trial courts may treat a spouse’s future business profits either as a marital asset subject to division, or as a stream of income for spousal support, but not both.”**

Rather, a double dip occurs when a court twice counts a future income stream – once in valuing the marital asset and once in deciding the economically superior spouse’s ability to pay support.

In Re Marriage of Gallo, 2015-Ohio-982 – Very briefly, this case dealt with the double dip and referred to the Heller case. I just want to point out one thing that The Court of Appeals stated in this case; "Double dipping, however, does not entail the double counting of a marital asset. Rather, a double dip occurs when a court twice counts a future income stream – once in valuing the marital asset and once in deciding the economically superior spouse's ability to pay support. It is the future income stream, not the marital asset, that is the subject of the doubling in the double dip. Thus, if the marital asset is valued without specific reliance on a future income stream-say, through a market-based or asset-based approach – then no double dipping occurs."

The takeaway from these cases is that the ultimate valuation methods and corresponding valuation adjustments are what the Court relies on to make its decisions regarding the double dip. This may seem like subtle issue, but the financial results could be significant if not addressed.

Double Dip and the Defined Benefit Plan:

Sometimes one (or both) of the spouses will receive a monthly retirement payment in which the amount is predetermined based on length of employment, earnings, etc. This differs from an IRA, 401k or defined contribution plan since these monthly payments are based on the actual dollars in the plan at the time payments are made.

At any point in time, an employee should know what the estimated monthly payments will be upon retirement, but there is no current value ascribed to the plan. With IRA's, 401k's or defined contributions plans, the employee knows the current value, but not what the specific future monthly payments will be.
So the question now becomes, how to consider the double dip as it relates to a defined benefit plan. Let's assume that wife works for a company with a defined benefit plan. She worked for the company prior to marriage and will continue to work for another five years after marriage. There is obviously a community and separate property component of the future monthly payment. For illustration purposes, let's say that everyone agrees the wife's portion of the plan (her separate property component plus 50% of the community portion) is 66% and husband's portion will be 34%. As of today, when the assets are being divided, there is obviously no cash from the defined benefit to split (unlike an IRA, 401k or defined contribution). So how do you divide it? One

alternative is to determine the present value of the future payments, taking into account post date of marriage contributions as well as an "expected life" of the wife, then come up with a present value of the future payments (don't forget to take into account the future taxes), take 34% of that number and have wife give husband other assets that equal that number. Another option is to QDRO the plan and when the time is right, husband can get 34% of the monthly payment and wife gets 66%. So where does the double dip come in? Let's suppose wife "buys out" the husband from his interest in the plan. Down the road, when wife is now receiving her monthly pension payments, husband files for modification. Wife's only income is her pension payments. Husband has no income at all. Should you consider wife's monthly pension payments as income? She already gave him assets equal to a portion of her monthly pension income. Now he expects her to pay support based upon her entire pension income…….which she claims is a double dip. Maybe the Court should say that 66% of her monthly pension is income that is available. But then wouldn't you need to consider 34% of the amount as income to husband since he received it as a lump sum after tax payment at the time of the divorce? Isn't that what would be happening if the plan had been QDRO'd and they were both receiving monthly payments?

As with the business valuation double dip concept, you need to be aware of the potential issues that can arise, either at the time of the divorce or down the road regarding a potential double dip argument.

Double Dip and the Stock Options:

Stock options are often awarded as a form of compensation. However, due to the vesting period, they may not be turned into cash until sometime in the future. The question is the determination of what portion are assets, income or both, as well as a community versus separate component. *[As an aside, on March 24, 2017 Oksana Holder, Esq. of Hallier and Lawrence and I will be giving a presentation on "Stock Options – Asset or Income…and How Much is Community". This presentation is through the Family Law Section of the Maricopa County Bar Association.]*

The double dip issue is going to rise when the unvested stock options are divided between the parties at the time of divorce, then they are subsequently exercised and sold. How much, if any, should be included in the parties' income? Again, you are going to have to look at the original division of assets, the purpose of the stock options being granted and the frequency with which they are granted. As with the business valuation and the double dip conflict, the double dip issue and stock options requires the same type of analysis and consideration of not only the asset but also the determination of how the asset is valued and divided.

Summary – This entire concept of the double dip is something that could have a major impact on the financial aspects of the divorce. Every case has its own facts and circumstances to deal with, but whenever you have a business valuation, stock options or defined benefit plan and maintenance/support, you must consider the potential impact of the double dip. It may not happen every time, but to not consider it can have catastrophic results for your client.

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David Cantor, CPA/ABV has been working almost exclusively in Family Law Accounting since 1990 in both Arizona and California.

He has worked on over 1,000 Family Law cases and has

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experience in all aspects of Family Law Accounting including Business Valuations, Separate Property Tracings, Calculation of Income for Purposes of Determining Maintenance and Support as well as many other financial issues.

Mr. Cantor has testified in Court over 100 times as an expert witness.

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