

## NICHOLAS J. CIPRIANI INN OF COURT 12/07/22 MEETING

### BUSINESS VALUATIONS: Definitions and Additional Comments

- (1) Income Approach - valuing a business on the basis of the expected future income stream, which is often referred to as “capitalization.” For example, if a spouse is a dentist and owns a dental practice, how much revenue could someone who buys the practice expect to make?
- (2) Market Approach—valuing a business based on other transactions of similar businesses. For example, if one of the spouses owns a trampoline park franchise, have there been sales of other franchises or similar franchises in the area/recent time frame?
- (3) Asset-based Approach—valuing a business on the basis of the assets and subtracting the debts it owes. For example, if a spouse owns a jewelry store, how much is the inventory, plus the computers, display cases, etc., worth?

#### Additional Comments:

For the income approach, we consider the net income from the business, the capitalization rate, and the discount rate.

The capitalization or “cap” rate is the expected growth which we would expect over time. This considers whether the business income is growing, shrinking, or remaining the same.

The discount rate refers to the discount that someone would pay today for income to be received in the future.

Personal goodwill is the value that is attributed to a particular person or owner. Usually it comes from personal expertise or a business relationship.

For example, if a dentist owned “Smiles Dentistry” there might be people who would still come to the practice if the owner Alex Smith DMD no longer worked there. However there would be other patients who would want to see Dr. Smith and their business would not transfer to a third party buyer. This personal goodwill might be a reason that a new purchaser keeps the prior owner as an employee for a period of time. The important part is that in Pennsylvania, the goodwill attributed to a person is not part of the marital estate and is therefore not part of the company value when considered for purposes of equitable distribution.

There are also other discounts – principally a marketability discount (how easy is this business to sell) and a lack of control discount (which is related to ownership interest – there is a discount if the owner has an interest of 50% or less).

In addition, valuations should consider the tax consequences of the sale. This might be called a Balicki adjustment after Balicki v. Balicki, 4 A.3d 654 (Pa. Super. 2010). A Superior Court case where the court upheld the trial court's considerations of the tax ramifications of sale, whether or not the sale is immediately anticipated. Balicki dealt with a multi-generational family business and the non-owner spouse argued that the business was unlikely to be sold and therefore an additional discount should not apply. The court rejected this reasoning, reading the statute to require the consideration of tax expenses as if the business were being liquidated.

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### BUSINESS VALUATIONS: Selective Case Law, Statutes and Articles

#### Case Law:

1. Date of Valuation:
  - a. Fishman v. Fishman, 805 A.2d 576 (Pa.Super., 2002)
  - b. McNaughton v. McNaughton, 603 A.2d 646 (Pa.Super., 1992)
  - c. Naddeo v. Naddeo, 626 A.2d 208 (Pa.Super., 1993)
  
2. Sole Proprietorship/Goodwill:
  - a. Beasley v. Beasley, 518 A.2d 545 (Pa.Super., 1986)
  - b. Perlberger v. Perlberger, 626A.2d 1186 (Pa.Super., 1993)
  
3. Tax Ramifications and Cost of Sale:
  - a. Carney v. Carney, 167 A.3d 127 (Pa.Super., 2017)
  - b. Balicki v. Balicki, 4 A.3d 654 (Pa.Super., 2010)
  - c. Hovis v. Hovis, 541 A.2d 1378 (Pa.Super., 1988)
  
4. Partnership and Shareholder Agreements:
  - a. McCabe v. McCabe, 543 A.2d 558 (Pa.Super., 1986)
  - b. Butler v. Butler, 663 A.2d 148 (Pa.Super., 1995)
  
5. Goodwill:
  - a. DeMasi v. DeMasi, 530 A.2d 71 (Pa.Super., 1987)
  - b. Gaydos v. Gaydos, 693 A.2d 1368 (Pa.Super., 1997)
  
6. Retention of Expert:
  - a. Bielski v. Brakender, (2001 PA D+C, 531)
  
7. Valuation Method :
  - a. Brubaker v. Brubaker, 201A.3d (180. Pa.Super., 2018)

#### Statutes:

23 Pa.C.S.A.3502(10.1) and (10.2) and 2004 comment

Articles:

Business Valuation in Pennsylvania Divorce: Consequences of Sale Costs and Tax Effect, <https://www.macelree.com/business-valuation-in-a-pennsylvania-divorce-consideration-of-sale-costs-and-tax-effect>, by Ashley B. Stitzer, Esquire.

Goodwill: Is goodwill a marital asset that can be distributed in a divorce? Colgan and Associates, <https://www.cmlaw1.com/6488-2/>

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