



Mayer
Hoffman
McCann P.C.
An Independent CPA Firm

For What It's Worth

Fall 2006

CBIZ Litigation & Valuation Services

Greetings everyone,

I have been noticing the changing season is upon us. I enjoy the seasonal changes in our wonderful Colorado and hope you are also enjoying the cool down.

We've included an article addressing the concept of an augmented estate in this issue of our quarterly newsletter. We were recently involved in litigation relating to this concept. The article reminded me of an important property concept in the context of marital dissolution. Similar to the intention of "disinheriting" a spouse, a propertied spouse might change the asset mix in the marital estate from liquid assets to illiquid assets. The spouse could then claim that the illiquid assets should be discounted for illiquidity (lack of control and lack of marketability).

This might be a valid investment decision for certain investors. On the other hand, the purpose of the decision could be to artificially reduce the value of the assets in the marital estate. This is something to keep in mind when you are reviewing those marital balance sheets and recent changes in the nature of the assets.

We've also included an article on using stipulations. The lesson from this article is simply to be cautious in the use of stipulations without sufficient facts.

As always, I hope all of you are doing well. Please give us a ring if you'd like to get to know us, we'll buy lunch. If you'd like to sign up for additional copies of our newsletter or to opt-out of receiving it, please email lvnews@cbiz.com.

Kind regards,

Eric Six, CPA/ABV

No Discounts When FLP is Created to Disinherit Spouse

In the Matter of the Estate of Norman B. Hjersted, 2006 Kan. App. LEXIS 517 (June 2, 2006)

If you're unwilling to suffer the financial consequences of divorce later in life—then don't expect to escape them at death. That appears to be the "life" lesson of the *Hjersted* case; the valuation lesson concerns the application of discounts to an FLP that one spouse creates to disinherit the other.

Apparently, the late Mr. Hjersted wanted to cut his wife out of his will. In 1997, after nearly twenty years of marriage, he created a family limited partnership (FLP) to hold all the outstanding shares of his company; he became a 2% general partner and a 96% limited partner of the FLP, and his son by a prior marriage a 1% general partner and 1% limited partner. Three years later, in March 2000, he transferred his 96% limited partnership interest to his son as part gift/part sale. He also set up his will to "pour over" the remaining probate assets into a trust, for which his son was trustee. A year later Mr. Hjersted died, and his wife sought her spousal elective share of the estate.

Elective share prevents decedent from disinheriting wife

As with most states that have enacted an elective share, Kansas adopted its statute from the Uniform Probate Code, which gives a surviving spouse the right to elect a percentage of the augmented estate (to which certain uncompensated, non-probate transfers have been added) based on the length of the marriage. The purpose is to prevent one spouse from disinheriting the other, and the rationale is based on similar "partnership" and "support" theories which underlie the uniform dissolution of marriage laws: During their

Continued to next page...

before the parties separated, HDC closed on a residential park, which required \$91,000 from community property and a \$600,000 bank loan.

HDC later paid off the bank by obtaining construction financing with proceeds from the sale of other property developed during the marriage. During the pendency of divorce proceedings, HDC earned over \$2.6 million from the development and sale of the residential park.

In a settlement conference, the parties stipulated to value the husband's interest in HDC as of the date of separation instead of the future trial date. A year and a half later, the wife "fired" her old attorneys, hired new ones, and moved to set aside the stipulation.

The husband had failed to disclose the \$2 million profits from community assets, she said, and had misrepresented HDC's value on his disclosures as worth only \$20,000.

In response, the husband pointed out that rather than risk the company declining in value during the divorce, the wife had asked for the valuation date to be the day of separation. Further, she knew the details of HDC's latest deal, including its potential earnings, because the community had contributed the down payment and the wife had requested a support modification based on his anticipated profits. Finally, the husband claimed that he'd made all the required financial disclosures and in any event, California law would have established the separation date as the proper valuation date.

The court upheld the stipulation, and nearly two years after its signing, the parties went to trial.

Wife tries to "back door" the \$2.1 million post-separation profits

In reaching a \$3.2 - \$3.5 million valuation for HDC, wife's primary expert had reviewed the company's financial and tax documents as well as the husband's disclosures.

He had also relied on a valuation of the undeveloped lots, prepared by wife's real estate appraiser, and then added the projected proceeds from their development, discounted by 30% for the risk of non-completion. His

rationale: the company had used profits from prior projects to develop the residential park, which it could only realize on the latter's sale.

The husband's experts reviewed the same records and found that as of the date of separation, HDC owned \$871,951 of hard assets (including the land for the residential development), plus \$49,058 for goodwill, for a total value of \$921,009.

The husband also disputed the wife's use of "hind-sight" when her expert included post-separation proceeds from the residential deal into his valuation of HDC. Instead, he should have relied only on the facts that a "reasonable person" would know at the time of valuation/separation. On cross-examination, husband's expert had also admitted that his valuation of HDC was the "first time" he'd evaluated a business using information not known as of the valuation date.



Be careful what you stipulate to

The trial court agreed with the husband, adopting his valuation of HDC. The court found no support to include post-separation profits, given the parties' original stipulation to value the company as of the separation; and the appeals court confirmed on both counts.

Specifically, with regard to the stipulation, the parties had received legal assistance and the agreement was reasonable. The wife "was not kept in ignorance regarding HDC's development," the appeals court said, "or in any way prevented from full participation in the dissolution proceedings." Any failure by the husband to disclose the value of HDC did not amount to fraud, as the information was available through discovery.

The wife couldn't claim mistake, as it is "hornbook law" that a party bears the risk of mistake when he or she is aware, at the time of making the contract, that only limited knowledge of the facts is available—yet treats this limited knowledge as sufficient.

Sounds much like what we all do when getting married; but at least during a divorce, there's ample time to make sure you (and your appraiser) get all the facts.

The CBIZ Litigation and Valuation Services group has been practicing in the Denver area since 1988. Our specialized expertise includes:

Family Law

- Asset Tracing
- Business Valuation
- Tax Aspects of Divorce
- Lifestyle Analysis
- Gross Income Analysis
- Professional Practice Valuation

Commercial Litigation

- Breach of Contract
- Business Interruption
- Buy/Sell Disagreements
- Intellectual Property Disputes
- Wrongful Termination
- Wrongful Death
- Personal Injury

Business Valuation

- Estate and Gift Tax Returns
- Shareholder Disputes and Dissention Actions
- Estate Planning
- Election of Subchapter S Status
- Mergers and Acquisitions
- Buy/Sell Agreements
- Partnership Dissolutions
- Stock-Related Employee Benefits
- Purchase Price Allocations
- Goodwill/Intangible Impairment Testing



®



Preston L. Hofer, CPA, MT - Director
Joseph Clement - Senior Manager
Eric D. Six, CPA/ABV - Senior Manager
Greg Norris - Manager

Phone: 720.200.7000

Fax: 720.200.7002

www.cbizcolorado.com

www.mhm-pc.com

**Mayer
Hoffman
McCann P.C.**
An Independent CPA Firm

©2006 Business Valuation Resources, LLC. No part of this newsletter may be reproduced or redistributed without the express written permission of the copyright holder. Although the information in this newsletter has been obtained from sources we believe to be reliable, we do not guarantee its accuracy, and such information may be condensed or incomplete. This newsletter is intended for information purposes only, and it is not intended as financial, investment, legal or consulting advice.

*CBIZ Accounting, Tax & Advisory Services &
Mayer Hoffman McCann P.C.,
An Independent CPA Firm
8181 E. Tufts Ave., Suite 600
Denver, CO 80237*