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Marmer Penner Newsletter

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# The Rice Stuff

*Rice and Rice* was a case heard by the Honourable Mr. Justice Jennings in October of 1996. The two significant valuation issues in this matter related to the value of the husband's business and the contingent disposition cost relating to the income tax liability on disposition.

Both parties retained experienced business valuators. Michael S. Penner was retained by Ms. Kirby Chown on behalf of Mr. Rice. Both valuators agreed on the fair market value of Mr. Rice's poultry brokerage business at $220,000 which included no component for goodwill. Both valuators agreed that fair market value is the most commonly-used definition of value of a business used in family law matters.

Mr. Penner, while disagreeing with respect to

The wife's valuator, however, put forward another value based on "Value to Owner" as the appropriate valuation method in this case. "Value to Owner" differs from "Fair Market Value" in that it considers non-transferable goodwill. In this case, Mr. Rice's business earned him a significant income. The wife's valuator testified that value to owner was the value of a particular asset to an owner given the current use being made of the asset. In a sense, it is the value of the loss to be experienced by the owner if the business was lost.

The wife's valuator testified that based on the value to owner approach, wherein he capitalized the business' income, he arrived at a value for the business in the range

of $740,000 to $1,140,000, which was about four to five times its fair market value. He conceded in cross-examination that no one would pay Mr. Rice anything like that amount to purchase the business, and that he gave this evidence using the value to owner approach because he was asked to do so by the wife's counsel.

Mr. Penner explained that the value to owner approach was appropriate in matters of expropriation where the loss to the owner must be calculated and should consider the loss of non-transferable goodwill as a matter of equity. He did not think it was an appropriate method in this family law case.

the appropriateness of this approach in family law matters, calculated a value to owner value of $350,000.

The main reason for the difference between the two calculations for value to owner was that Mr. Penner allowed for a salary of $135,000 for the value of Mr. Rice's management services before arriving at a value for maintainable earnings. The wife's valuator made no such allowance which ignores the fact that a business' income stream, unlike that from a passive investment, requires significant time and effort on the part of its owner.

The Honourable Mr. Justice Jennings rejected the value to owner approach as "not helpful in determining the value of the husband's business in this case, regardless of whether it has any use in Family Law in general," and determined the value of the business to be its fair market value of $220,000. Mr. Justice Jennings added that had he accepted the value to owner approach as appropriate, he would have accepted Mr. Penner's value as deducting a reasonable salary to the manager before determining maintainable earnings "made sense".

It should be noted that in argument, Mrs. Rice's counsel abandoned support for the wife's valuator's calculation of value to owner and accepted Mr. Penner's report as appropriate.

In calculating how Mr. Rice was to pay an equalization to Mrs. Rice, Mr. Penner determined the most appropriate and tax-efficient way to do so was to have Mr. Rice's business pay him a taxable dividend. As a result, Mr. Penner included an income tax liability at the valuation date of $24,696 in computing Mr. Rice's net family property. Mr. Justice Jennings accepted this value, and cited *Sengmuller* as the authority for the proper deduction of this contingent disposition cost.

In a separate matter, Mr. Penner calculated the contingent disposition cost of Mr. Rice's remaining interest in the business at $21,197, being the present value of the tax on the eventual windup of the business when Mr. Rice reached sixty-five years of age. Mr. Justice Jennings rejected this liability as both too remote and contradictory to Mr. Rice's testimony that he would run his business for the duration of his life.

Readers may recall that *Sengmuller* contemplates that all contingent dispositions costs should be adjusted for a present value factor based on the time between the valuation date and the date of expected realization of these disposition costs. Accordingly, even if Mr. Rice held his business until death, his estate would still face a liability on the deemed disposition at that time. Not only are death and taxes the two constants of which we must always be wary, but we should also remember that the former triggers even more of the latter!

***This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper tax planning. The professionals at Marmer Penner will be pleased to assist you with any matters that arise.***