NFLR NEVADA FAMILY LAW REPORT

A Publication of the Family Law Section of the State Bar of Nevada

Volume 1, Number 1 March, 1986

Valuation of Stock in Closely Held Corporations in the Context of a Matrimonial Action

BY KENNETH L. FORTNEY

Introduction

The value of stock in a closely held corporation frequently represents the most significant asset of the marital estate. Those shares must be valued and included in the property division. The valuation of a closely held corporation or an interest in such corporation may represent one of the most perplexing and difficult tasks at the time of marriage dissolution.

Each valuation problem is unique; there is no one proper valuation theory to be applied in all instances. The question of value is one of fact and therefore subject to solution only in the light of all circumstances having a bearing on the issue as of the valuation date. It is, furthermore, a matter which is to be resolved in all cases on the basis of sound judgment and common sense. There is no mathematically "right" answer, only a range of possible right answers which can be supported by convincing and logical reasoning. In each case the expert must be sure there is ample justification for the value placed on the shares of a closely held corporation.

Related to the valuation of stock in a closely held corporation are appraisals of other kinds of business interests: partnership or sole proprietorship interests; associations; joint ventures; and other noncorporate entities. Most of the same factors used in valuing stock in closely held corporations apply equally well to the valuation of such other business interests.

A closely held corporation has been defined "as a corporation... the shares of which are owned by a relatively limited number of stockholders. Often the entire issue is held by one family."[1] Further, its stock is rarely traded and is unlisted on any exchange. It has also been defined by the Internal Revenue Service as "a corporation whose market quotations are either unavailable or of such scarcity that they do not reflect the fair market value.[2]

"Value" and "valuation" can be defined a number of ways, depending upon the particular context in which they are used. Most commonly, they have been judicially defined as "fair value" or "fair market value." The Internal Revenue Service defines the "fair market value" of property in general as "the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."[3] Inherent in the definition of fair market value is the willing buyer-willing seller concept. Obviously, the best indicator of such a concept is the open market where buyers and sellers communicate with one another and where exchange takes place. A lack of such a market for stock in a closely held corporation compels the need for a valuation process.

The Valuation Process

The valuation process is generally a two-stage procedure. In the first stage, the appraiser determines the gross value of the stock in the closely held corporation. In the second stage, the appraiser would adjust the first-stage estimate to account for factors which a market would consider in valuing stock but which ordinarily would not be taken into account when calculating the value of a company. Second-stage adjustments include discounts and premiums. An appraiser's final estimate of value of the shares of stock at issue would be the first-stage estimate of value properly adjusted in accordance with all relevant second-stage factors.

Revenue Ruling 59-60 may be the single most important summary of accepted valuation objectives and techniques for closely held corporations or an interest in such corporations. This Revenue Ruling specifically lists eight factors to consider in valuing the shares of stock in a closely held corporation. The relevant valuation factors set forth are as follows:

(a) The nature of the business and the history of the enterprise from its inception.
(b) The economic outlook in general and the condition and outlook of the specific industry in particular.
(c) The book value of the stock and the financial condition of the business.
(d) The earning capacity of the company.
(e) The dividend-paying capacity.
(f) Whether or not the enterprise has goodwill or other intangible value.
(g) Sales of stock and the size of the block of stock to be valued.
(h) The market price of stock of corporations engaged in the same or similar line of business having their stock actively traded in a free and open market, either on the exchange or over-the-counter.

Continued next page

In This Issue

NEVADA FAMILY LAW REPORT is a quarterly publication of the Family Law Section of the State Bar of Nevada. Mailing address: 243 South Sierra Street, Reno, Nevada, 89501 (702) 786-5040.

SUBSCRIPTION PRICE FOR NON-SECTION MEMBERS is $35 payable in advance annually from January 1 to December 31. There are no prorations.

This publication may be cited as 19__ NFLR ________.

Nevada Family Law Report is supported by the Family Law Section of the State Bar of Nevada, NFLR subscriptions, and the following corporate sponsors:

First Interstate Bank
Grant Thornton
The Baker Group

Welcome to the Nevada Family Law Report!

The Family Law Section has embarked upon a rather ambitious program, publication of the *Nevada Family Law Report*. The NFLR is intended to provide authoritative family law material useful to both bench and bar. It will be published at least quarterly with each issue referenced by volume, number and date. It may be cited as 198__ NFLR ________.

The subscription year is January 1 to December 31. Members of The Family Law Section will receive NFLR as a part of their dues. Subscriptions for non-section members, libraries and other interested persons is $35. annually, payable in advance. There are no prorations.

This complimentary issue has been distributed to all members of the bar. Hereafter, only Section members and subscribers will be included for mailing. A subscription form is provided in this issue.

The success of this publication will necessarily depend upon the willingness of the bar and other professionals to contribute to its content and organization. Suggestions and comments are welcome. Request authors guidelines by writing to NFLR, 243 South Sierra, Reno, NV 89501.

Your support is encouraged!

Ronald J. Logar

Revenue Ruling 59-60 also provides a brief discussion of each of the foregoing factors. The purpose of the ruling is to summarize the factors to be considered in valuing shares of stock in closely held corporations for estate and gift tax purposes. However, several divorce courts have concluded that all of the factors noted in Revenue Ruling 59-60 should be considered in order to establish an appropriate value of an interest in a closely held corporation.[4]

Of the factors outlined in Revenue Ruling 59-60, this article focuses on capitalized earnings, net asset value and representative sales or exchanges.

Capitalization of Earnings

Earnings may be the single most important factor in determining the value of stock in a closely held corporation. The essence of value in such assets is their income-producing ability; past, present and potential. Daily evidence of the importance of earnings is seen from the stock market analyses which refer to the price-earnings ratios of shares of various companies. Authorities on valuation, other than for tax purposes, have placed even greater weight on earnings in valuing operating businesses. For example, Dewing states:

> The businessman, frankly, is interested neither in the engineer's appraisal of physical property, according to some arbitrary rule of unit values, nor in the accountant's report of past expenditures. He is primarily interested in the past earnings capacity of the business so far as this can throw light on future earnings in his hands. He is buying earning capacity and not physical assets.[5]

In making a valuation of shares of a closely held corporation by reference to earnings, it should be kept in mind that what a hypothetical willing buyer would pay a hypothetical willing seller is based upon the expected future earning power of the corporation. In predicting future earning power, past earnings are usually the most reliable guide.

In determining future earning power by reference to past earnings, several points must be examined. Revenue Ruling 59-60 states that preferably five or more prior years earnings should be taken into account. Usually five years is an appropriate period to consider. Whatever period of prior earnings is used, the earnings for that period are not simply averaged in order to arrive at predicted future earnings. Earning trends must also be considered. Comparative income statements for the last five years should be scheduled. Trends of income statement items such as sales, gross profit, income from operations, net income and earnings per share should be analyzed. Adjustments should be made for nonrecurring items, shareholder-officers' salaries or loans, shareholder-officers perquisites, unreported income and unreported expenses. After the adjusted earnings are determined they should be average for the five-year period. If the earnings show an upward or downward trend, the earnings should be weighed to emphasize the trend. This method gives greater weight to the final year's earnings. The earnings from the most recent to remote period are weighed according to factors 5, 4, 3, 2 and 1. The result is weighted average earnings.

Continued next page

Once average earnings have been determined, an appropriate price-earnings multiplier, or capitalization rate, must be determined and applied to those earnings. The earnings multiplier is the reciprocal of the capitalization rate. The capitalization rate is the rate of return that a new investor going into a particular industry would expect on his or her investment, as affected by the risk of loss and the prevailing rate of return other investors in the same industry are receiving. The riskier the business, the higher the capitalization rate. The higher the capitalization rate, the lower the value of capitalized earnings.

Valuation based on earning power can vary greatly depending upon the multiplier (capitalization rate) chosen. A comparatively large error in computing average earnings is not of as much importance in the final result as a comparatively small difference in the ratio at which earnings shall be capitalized.

The best guide to finding the appropriate price-earnings multiple is to determine the price earnings multiples of comparable companies whose shares are publicly traded. The problem, however, is to find a company which is publicly traded that is truly comparable. A comparable company should be one whose lines of businesses are the same as that of the company whose shares are being valued, and it should also be of approximately the same degree of riskiness.

Net Asset Value

Net asset value is the fair market value of all assets less liabilities. Net asset value is also referred to as adjusted book value. Book value represents the total assets of the company based on its financial statements less stated liabilities, commonly referred to as stockholders' equity. Book value per share is the total book value or stockholders' equity of the company divided by the number of issued and outstanding shares.

The stated assets on the corporation's financial statements will usually be at cost, or sometimes at the lower of cost or market value. The book value per share of shares of a corporation may have little relation to the fair market value of assets underlying each share. For example, the historical cost of land reflected in the corporation's financial statements may be far below its current fair market value.

At the valuation date the stock of the corporation had a certain net asset value or book value. Ordinarily, we cannot find balance sheets as of the specific date; thus the alternative is to use the latest available financial statement. The latest balance sheet available should be analyzed and adjusted to net asset value. As previously indicated, real estate must be adjusted to its current fair market value. A current appraisal may be required. Depreciation schedules of all principle classes of fixed assets should be reviewed. Machinery and equipment may be fully depreciated or depreciated under an accelerated method. It may be necessary to have these items appraised. The allowance for uncollectible accounts receivable should be analyzed. The basis of valuing inventory should be examined since net asset value and earnings will vary depending on the inventory valuation method applied.

The above items are only a few of the balance sheet factors considered in a typical stock valuation. An important aspect of the net asset value study is to compare such significant items as working capital ratio or ratio of total debt to equity. Balance sheets for the last five years should be scheduled. Ratios for these same balance sheets should be scheduled and evaluated. Such a comparison gives greater meaning to the various balance sheet disclosures for valuation purposes.

Net asset value is generally a poor indicator of value in an operating company, but is considered the preferred method in evaluating the value of an investment or real estate holding company.

Representative Sales or Exchanges

Comparable sales are always a measure of fair market value, whether for real estate, personal property or a going business. The general rule is that market prices determined in a free and open market are the best indicators of value, and that such prices should be used in determining value whenever possible. Judge Learned Hand has articulated the rationale for this rule as follows:

> When there is an open market in which property can be bought and sold, it may be very difficult, if not impossible, to avoid the conclusion that the market price is the 'value' for all purposes. That price is the sum which will secure the property if anyone wishes to buy it, or will replace it if anyone has parted with it; the price is the sum which represents the current estimate of the present value of its earnings and of its final liquidation.[6]

During the examination of the entity to be valued, it should be determined if: (1) there is an indication that a contemporaneous sale occurred; (2) such transaction, if any, was at arm's length; and (3) the parties to such transaction had full knowledge of the conditions surrounding the transaction. If such questions are answered in the affirmative, then the appraiser has a good value basis upon which to build. Even if all of the above three elements are not present, a starting point for the valuation process has been established. The market in which sales occur before or after the valuation date must be examined. Such market should generally be free from abnormal influences or pressures and be truly representative of a willing buyer and willing seller negotiating for a sales price at arm's length.

The general rule for use in representative sales is that the closer the sale is to the valuation date, the greater the weight the sale will receive. The amount of weight a representative sale will receive depends largely upon the change in financial condition of the subject company during the intervening period between the valuation date and the representative sale date.

The size of the representative sale must also be considered. Obviously, the closer the representative sale size (shares of stock, percentage interest, etc.) is to the interest to be valued, the more credible the representative sale value. On a comparative basis, if the size of the interest sold is within reasonable range of the size of the interest to be valued, and the market conditions have remained substantially the same, then a representative sale should provide the needed indication of value, provided the original sale was a bonafide sale.

Those sales involving non-arm's length or private transactions must be analyzed. Sales of business interests among family members subsequent or prior to the valuation date have a lesser bearing on determination of fair market value than do other representative sales. The preferential treatment generally given family members in intrafamily transactions creates a non-arm's length implication even though the substance of a bonafide sale may be present. The implication that a "donative" intention is involved in many intrafamily transactions has been recognized by the courts.

Sales of business interests between or among so-called "corporate insiders" before or after the valuation date may be considered fairly reliable for determination of a relevant value range. The reasoning is that insiders generally are well informed of the true status of the entity, have a better understanding of the worth of the business, and have negotiated in a "willing seller-willing buyer" environment. The sales price of the interest sold when corporate insiders are involved must, however, be closely examined to make sure no additional consideration is involved (e.g., performance of services or other forms of disguised payments).

A representative sale may receive more weight if the Internal Revenue Service has accepted, or failed to contest, the value used in such sale. If, for example, shares were sold

Continued next page

wherein the taxpayer had significant long-term capital gains and such gains were not contested or disallowed upon audit of the taxpayer's return, then the real value has withstood Internal Revenue Service scrutiny.

In summary, some weight should be given to representative transactions occurring before or after the valuation date. The amount of weight afforded such representative sales will depend upon the following elements:

- the proximity of the sale to the valuation date;
- the amount of disparity between the number of shares sold and the number of shares to be valued;
- the motives surrounding the sale, other than to determine a fair price; and
- the amount of intervening change in the financial condition of the business and environment from the sale date to the value date.

These conditions determine the degree of reliance which should be placed on representative sales.

Discounts

The question of discounting from gross value in order to arrive at a fair market value must be considered. After the appraiser determines the gross value of the stock in the closely held corporation, discounts from gross capitalized values are allowable for any of the following reasons:

- Lack of marketability
- Minority interest
- Restrictive agreements

1. *Lack of Marketability*

By far the most frequent claim for substantial discounts in value of closely held securities is made on the basis that the stock lacks marketability. The extent, however, to which any restriction or limitation on marketability will reduce the value of a specific stock as of a certain date is entirely a matter of opinion.

2. *Minority Interest and Control Premium*

One of the significant problems in the valuation of shares of closely held corporations is whether and to what extent a reduction from the value otherwise determinable for such shares may be allowable by reason of the fact that the block of shares being valued is a "minority" interest in the business; or conversely, whether or to what extent an increase in value is in order because the shares represent a controlling interest.

The minority interest discount principle is, again in theory, distinct from the lack of marketability principle since lack of marketability is present whether a minority or a controlling interest is involved. The courts, however, tend to lump the minority interest and lack of marketability principles together and apply a single discount.

Minority interest shares in a closely held corporation are usually not readily saleable because they lack the power to control the election of the board of directors which oversees corporate policy with respect to issues such as officer salaries, dividends and liquidation of assets. Often times, the field of potential buyers or minority interest stock is limited to the group consisting of the controlling shareholders.

Ownership of a controlling interest in a closely held corporation entitles the control block owner the powers to elect and remove directors, fix salaries, assure oneself a job at a reasonable salary, declare dividends and dissolve or merge the corporation.

In general, a minority discount and/or a control premium can only be supported if an acutal control interest exists. If there is a control interest, the appraiser must decide whether the block of stock at issue is a control interest or a minority interest.

For purposes of determining whether a given block of shares represents a minority or a controlling interest, the courts have generally adopted the rule that more than 50 percent of the voting shares constitutes a controlling interest and less than 50 percent constitutes a minority interest.

Since premiums and discounts rest on the hypothesis that the control interest can and will divert from minority interests portions of the latter's pro rata claims to corporate income and assets, and since such diversion inherently is an illegal act from which minority interests are entitled to relief under most states' laws, we should presume that diversion will not take place and therefore that control premiums and minority discounts are unwarranted.[7]

A possible exception to this general rule might be allowed — and thus a control premium or minority discount considered — if the party urging such an exception can prove that, due to the costliness and riskiness to minority interests of enforcing their rights to pro rata treatment, diversion activities by the control interest can be expected in the particular case at hand.[8]

The burden always should be on the party urging the premium or discount, and the court should demand that that party present, at the very least, evidence showing that under the laws of the state of incorporation the minority interest would have a particularly difficult time obtaining relief from diversion. The burdened party also should have to prove with some measure of certainty the degree to which diversion activities could be expected in the case, and this should require a showing that private diversion-preventing arrangements were not used by minority shareholders. If the burdened party in the case could successfully prove the degree of diversion that can be expected, then the court should apportion the present value of expected diversion from minority interests in the corporation to majority interests, thus assessing the proper control premium or minority discount in the case.[9]

In several instances, the interest at issue may represent an ownership interest in a family-owned corporation. Generally, no minority interest discount should be contemplated for transfers of shares of stock among family members where at the time of the transfer either majority voting control or de facto control of the corporation exists in the family. However, where there is evidence of family discord or other factors indicating that the family would not act as a unit in controlling the corporation, a minority interest may be appropriate. Generally, there is unity of ownership and interest in a family corporation, and the shares owned by family members must be valued as part of that controlling interest. Typically, shares that are part of the controlling interest in a closely held corporation are unlikely to be sold in an arm's length trans-action except as part of the controlling block. Thus where the family owns a controlling interest in a corporation, the value per share is the same as stock owned by any other family member and is the same value that would exist if all the stock were held by one person.

3. *Restrictive Agreements*

Frequently in valuing closely held stock, it will be found that the stock is subject to an agreement restricting its sale or transfer. Agreements are executed, for example, to keep ownership and control of the enterprise within a limited group and to assure that new entrants into the stockholding group are acceptable to the owners.

Unlike the nonmarketable and minority interest discounts, the existence of a restrictive agreement does not create the opportunity for a percentage discount from a gross valuation derived from intrinsic factors. Rather, the restrictive agreement, containing as it usually does a designated purchase price derived under a negotiated price or formula scheme, may be, depending upon form, determinative of value. In other situations the presence of a restrictive agreement may simply be a factor to be considered in arriving at a reasonable rate.

Conclusion

This article has focused on the major issues and methods involved in the valuation of stock in a closely held corporation. In valuing an interest in a closely held corporation, the appraiser must analyze the corporation's capital and control structure, it's financial position and its future prospects with extreme care. In examining and weighing all relevant factors, he must make many judgments and choices which can significantly affect value. The real test of the appraisal lies in the ability of the appraiser to document and back up his valuation effectively and rationally. If the appraiser has been professional, the judgments reasonable, and the results supportable, the expert should be able to successfully defend his evaluation.

Kenneth L. Fortney, CPA, is a practicing accountant in Reno, Nevada, concentrating his practice in the area of closely held corporations, professionals and taxation.

NOTES

[1] Rev. Rul. 59-60, 1959-1 C.B. 237, Section 2
[2] Ibid, Section 1
[3] Ibid, Section 2
[4] See, e.g., In re Marriage of Hewitson, 142 Cal. App. 3d. 874, 882-83, 191 Cal. Rptr. 392, 397 and fn9 (1983); Kaye v. Kaye, 478 N.Y.S. 2d 324, 328 (A.D. 2 Dept. 1984); Muller v. Muller, 116 Misc. 2d 660, 668, 456 N.Y.S. 2d 918 (Sup. 1982); Nehorayoff v. Nehorayoff, 108 Misc. 2d 311, 316, 437 N.Y.S., 2d 584 (Sup. 1981)
[5] Dewing, "The Financial Policy of Corporations" 264 n.b. (rev. ed. 1926)
[6] Comr. v. McCann, 146 F. 2d 385 (2nd Cir., 1944)
[7] Hall, "Valuing Closely Held Stock: Control Premiums and Minority Discounts", 31 Emory L.J. 139 (1982)
[8] Ibid
[9] Ibid

CALENDAR

Family Law Seminar

December 5, 1986 - Reno

December 12, 1986 - Las Vegas

Sponsored by the State Bar of Nevada and the Family Law Section

Forrest v. Forrest: A Case of First and Lasting Impression

BY JAMES J. JIMMERSON and LYNN M. HANSEN

In August of 1983, the Nevada Supreme Court handed down *Forrest v. Forrest*[1]. In a case of first impression, the Court characterized property acquired during a separation but prior to a final decree of divorce as community property.

The Forrests separated in 1973 and during an eight year separation, Mr. Forrest purchased a mobile home. At trial, the district court held that the 1973 separation of the parties was the same as a dissolution of the marital relationship and sufficient to dissolve the community. Therefore, the trial court found that the property acquired after separation was the separate property of the acquiring party.

The Nevada Supreme Court reversed the trial court's order and found the mobile home to be community property. The court cited N.R.S. 123.130 which provides that all property of the spouse owned by him or her before marriage, and that acquired after marriage by gift, bequest, devise, descent, or an award for personal injury damages, with the rents, issues, profits thereof, is separate property. All other property acquired after marriage is community property[2]. The court further noted that N.R.S. 123.190 provides that one spouse may in writing authorize the other spouse to retain and control his or her earnings as separate property.

N.R.S. 123.220 permits the presumption of community property to be overcome by an agreement in writing between the spouses which authorizes property to be taken as separate property or a decree of separate maintenance issued by Court. Absent these statutory exceptions, the presumption that property acquired during marriage is community is difficult to overcome[3].

The Court in *Forrest* found that no written agreement or authorization between the parties existed, nor was a decree of separate maintenance obtained. In such a case, the court held that the statutes clearly mandate that all property acquired by the parties until the formal dissolution of a marriage is community property.

The Court's strict interpretation of N.R.S. 123.220 extends the presumption of community property to that property acquired during separation. Even spouses who are separated for long periods of time, as were the parties in *Forrest*, are subjected to the long arm of the presumption. Absent a writing evidencing the intent of the parties that property be separate or a decree of separate maintenance, N.R.S. 123.200 requires district courts to characterize property acquired during separation to be community, subject to equal division.

Continued next page

The *Forrest* decision has potential for producing some inequitable results.

The *Forrest* decision has potential for producing some inequitable results. There are other factors that should be considered by trial courts in characterizing property whether acquired during marriage or separation. District courts should retain the discretion to take into account the intent, actions and motives of the parties[4]. A strict reading of *Forrest* unduly confines the trial court to an inflexible rule.

Worst Case Scenario

It is not difficult to think of examples where the *Forrest* rule may produce undesirable results. If a married couple has made an oral agreement that property acquired after separation shall be considered to be the separate property of the acquiring spouse and one of the parties has relied upon that agreement, an unfair result would occur if the Court feels restricted by the *Forrest* rule and ignores evidence as to the parties' intent. In a worst case scenario, if one spouse prudently saves his/her income while the other spends his/her money during separation, a Court following *Forrest* would be required to penalize the thrifty spouse by dividing the savings and debts equally as community property and obligations.

It is still unknown at this time if the Forrest decision represents a trend or aberration of the Court.

The impact of *Forrest* on practitioners advising divorce clients is significant. Attorneys should advise their clients that during separation all income, purchases or investments are subject to division by the Court as community property. It is advisable that upon the filing of the Complaint or Answer, that a Temporary Restraining order be obtained restricting the other spouse from incurring large debts[5].

Some consideration should be given, if both parties are amenable, to the execution of a separation agreement whereby each party agrees that purchases, income, investments and debts incurred during separation are the property of the incurring spouse[6]. It is also advisable to use preferential trial setting to obtain an early trial date and decree of divorce.

Characterization of the Marital Residence

The other major holding of *Forrest* deals with the characterization of the marital residence. Mrs. Forrest claimed the residence was community property while Mr. Forrest alleged title was held as joint tenants. The District Court found the residence to be held in joint tenancy and ordered the residence sold with the net proceeds to be divided equally, or for Mrs. Forrest to purchase Mr. Forrest's interest.

The Supreme Court reversed the decision of the District Court and found the residence to be community property. The Court found the record contained no evidence beyond the statement of the parties as to the character of the property[7]. Thus, on the record, the Court held the property must be presumed to be community property[8].

Remarkably, despite finding the property to be community, the Court remanded the case to the district court with instructions to allow Mr. Forrest to introduce sufficient evidence, if available, as to the form of the deed in order to prove joint tenancy. The action of the Court is surprising because a deed was not offered into evidence to overcome the presumption of community property in the district court. Nonetheless, instead of ordering the lower court to divide the residence as a community asset, the Court provided Mr. Forrest another opportunity to prove the house was held in joint tenancy.

The Court's remand of the case for a determination of the character of the residence by the form of the deed appears to indicate that the form of deed presumption has at least equal strength to the community property presumption. That is to say, that the presumption that property acquired during marriage is community may not be stronger than the form of the title in which the property is held. The Court in *Forrest* specifically provided an opportunity for Mr. Forrest to overcome the community property presumption by offering evidence of the form of deed.

It is still unknown at this time if the *Forrest* decision represents a trend or aberration of the Court. However, the ramifications for the practicing attorney are clear. The form of the title, absent compelling and contrary evidence, is controlling. Mere intent of the parties, absent clear and convincing evidence of that intent, is unlikely to overcome the form of title presumption[9].

CONCLUSION

Forrest provides two important rules in the characterization of property held by a married couple. An attorney who practices family law would be well advised to study the case carefully.

James J. Jimmerson and Lynn M. Hansen are both admitted to the Nevada and California bars and are members of the Las Vegas law firm of Jimmerson & Combs.

NOTES

1. 99 Nev. 602, 668 P.2d 275.
2. N.R.S. 123.220
3. *See Todhill v. Todhill*, 88 Nev. 231, 495 P.2d 629 (1972); *Kelly v. Kelly*, 86 Nev. 301, 468 P.2d 359 (1970) (Presumption of community property can only be overcome by clear and convincing evidence).
4. *See* N.R.S. 125 (1) (b). But see N.R.S. 125 (1) (c).
5. *See* N.R.S. 125.050; N.R.C.P. 65 (b).
6. *See* N.R.S. 123.200.
7. *See Cord v. Cord*, 98 Nev. 210, 644 P.2d 1026 (1982); *Roggen v. Roggen*, 96 Nev. 687, 615 P.2d 250 (1980); *See also* N.R.S. 123.220.
8. *Peters v. Peters*, 92 Nev. 687, 557 P.2d 713 (1976).
9. *But see Neumann v. McMillan*, 97 Nev. 340, 629 P. 2d 1214 (1981) (Court found purchase of property with community funds, supporting affidavit and both parties alleging in the divorce pleadings that property was community property was sufficient evidence to find community property even though title was taken as joint tenants).

How to Divide a Diploma in a Divorce -- If At All

BY HARRY B. SWANSON

Prior to 1978, most matrimonial lawyers gave little thought, if any, to the subject of the valuation of a diploma achieved by one spouse spending his entire time obtaining such diploma — from which, hopefully, he would derive financial benefits in the future — while the other spouse worked to "put her husband through." A diploma simply had no value in the law. At the same time, any thinking matrimonial lawyer had to consider how unfair it was that on divorce the wife received nothing as a result of her efforts to support the husband while he was achieving his goal of a diploma.

Since 1978, however, the issue is not so certain, and as a matter of fact, has generated substantial matrimonial litigation.

To get to the meat of the problem, the fact situation is simple: Jack and Jill marry; Jill works and Jack goes to college; and in due course he receives a diploma. During the time of Jack's studies, the vast majority of Jill's earnings are spent in supporting herself and her husband. Shortly after Jack obtains his diploma, the parties divorce and there is little marital property accumulated because Jack has been going to school and Jill has been spending all of her money to support herself and Jack. What does Jill get from the divorce?

Continued next page

Under the majority rule as established by *In re Marriage of Graham*[1], she gets nothing, since plainly Jack's degree or diploma is not property. Jill, therefore, receives no benefits as a result of her efforts to achieve Jack's diploma, and she must resort to normal remedies of a wife in a divorce action, the division of other property, if any, together with (hopefully) obtaining some variety of alimony or support.

Other courts following the majority rule have suggested that if Jack's degree or diploma is divided in some manner, such requires a distribution of future earnings and this violates the principle of equitable distribution laws (in equitable distribution states), that only property acquired during the marriage is subject to distribution.[2]

There are, of course, minority views, one of which is exemplified by the case of *Woodworth v. Woodworth*[3], wherein the Michigan court takes an entirely opposite position to the Colorado court in *Graham*. Michigan plainly says that Jack's degree is property and that the proper measure of the value of his degree of diploma would be the future earnings it will generate.

And now comes New York and agrees generally with Michigan! In the very recent case of *O'Brien v. O'Brien*[4], the New York Court of Appeals, the highest court in New York, has

Whatever the case, the courts are having great difficulty in valuing a degree or diploma in the hands of the degree-earning spouse.

held that a medical license constitutes marital property within the meaning of the New York Domestic Relations Law. The Court awarded Mrs. O'Brien 40% of the value of the medical license held by her ex-husband.

Other courts in the minority try to avoid the harsh result of the *Graham* case by choosing the alternative of reimbursement of cost incurred by the working spouse who materially aided the other in obtaining a degree[5]. And "Reimburse Alimony" is another alternative, which is basically the sum of the financial contributions the supporting spouse made to the education of the degree-earning spouse. It might be said here that "reimbursement of costs" or "reimbursement alimony" is probably a pretty fair result in a case where Jack and Jill divorced very soon after Jack obtained his degree — but what is the situation if they divorce sometime later? Likely, the solution would be a more substantial alimony award than would be otherwise given.

Whatever the case, the courts are having great difficulty in valuing a degree or diploma in the hands of the degree-earning spouse. The difficulty is particularly accute if the court attempts to allow the non-degree-earning spouse to participate in a share of the future earnings of the degree-earning spouse — the court in such a case is entering an area of sheer speculation, better said, guesswork[7]!

To the knowledge of this writer, Nevada has done nothing yet, at least in our Supreme Court — what will our Supreme Court do when the issue is presented?

Harry B. Swanson is a Reno attorney in the firm Swanson & Capurro.

NOTES

1. *In re Marriage of Graham*, 574 P. 2d 75 (Col. 1978).
2. See *Hughes v. Hughes*, 438 So. 2d 146 (Fla. 1983) and *DeWitt v. DeWitt*, 296 N.W. 2d 761 (Wisc. 1980).
3. *Woodworth v. Woodworth*, 337 N.W. 2d 332 (Mich. 1983).
4. *O'Brien v. O'Brien*, NYLL, p. 4, col. 1, Dec. 30, 1985.
5. *Inman v. Inman*, 648 S.W. 2d 847 (Ky. Ct. App. 1982).
6. *Mahoney v. Mahoney*, 453 A. 2d 527 (N.J. 1982).
7. See *Mahoney v. Mahoney*, in fra.

BULK RATE
U.S. POSTAGE
PAID
PERMIT # 711
RENO, NV

NFLR
State Bar of Nevada
Family Law Section
243 South Sierra Street
Reno, NV 89501

CENDAGORTA, CHRISTINE
1950 WINDSOR WAY
RENO, NV 89503