

Business Valuations: The Importance of a Defensible Valuation in Divorce

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At Tax Options, LLC, we understand that business valuations in divorce require careful analysis and an appreciation for both the financial and legal issues involved.

When a business is part of a divorce, determining its value can become one of the most challenging—and most consequential—aspects of the case.

For divorce attorneys, the issue is rarely just, “What is the business worth?” The more important question is:

Can the valuation be supported, explained, and defended if it is challenged?

A defensible business valuation provides attorneys and their clients with more than a number. It provides a well-reasoned conclusion supported by appropriate financial information, valuation methodologies, professional judgment, and documentation.

A Business Is More Than Its Tax Return

Business owners often view the value of their company through the lens of revenue, profits, assets, or tax returns. But a professional valuation considers much more.

Depending on the circumstances, a valuation may require analysis of:

- Historical and current financial performance
- Normalized earnings and expenses
- Owner compensation
- Non-operating assets and liabilities
- Business and personal expenses running through the company
- Customer concentration
- Industry and economic conditions
- Business risk
- Marketability and liquidity
- Tangible and intangible assets
- Goodwill
- The company's future earning potential

The goal is not simply to select a valuation method and calculate a result. The goal is to understand the business, identify the relevant valuation issues, and develop a conclusion that can be reasonably supported.

Why "Defensible" Matters

In a divorce proceeding, it is common for each side to have a different opinion about the value of a closely held business.

One valuation may emphasize future earnings. Another may focus on the company's assets. One expert may make substantial adjustments to the financial statements, while another may reject those adjustments.

A valuation becomes particularly valuable when it clearly explains why its conclusion is reasonable.

A defensible valuation should allow the attorney, opposing counsel, mediator, judge, and other professionals involved in the case to follow the reasoning from the underlying financial information to the final conclusion.

That means documenting the assumptions, explaining the methodology, identifying significant adjustments, and addressing the factors that could reasonably affect value.

A defensible valuation is not necessarily the highest valuation or the lowest valuation. It is a valuation that can withstand reasonable scrutiny.

Normalizing the Financial Statements

One of the most important parts of many private-company valuations is determining what the company's financial performance would look like under reasonable, ongoing operating conditions.

Reported financial statements do not always tell the entire story.

A valuation professional may need to consider adjustments for items such as:

- Excessive or inadequate owner compensation
- Personal expenses paid by the company
- One-time or unusual expenses
- Nonrecurring income
- Related-party transactions
- Above- or below-market rent
- Family-member compensation
- Non-operating assets

These adjustments can materially affect a company's normalized earnings—and therefore its value.

The key is that adjustments should be reasonable, supportable, and clearly explained.

The Importance of Professional Judgment

Business valuation is not simply a mathematical exercise - it is professional judgment rendered on many different levels and clearly reported in the Valuation Report.