Valuation of Spousal Interest in a Professional Practice for Equitable Distribution: Hirschfeld v. Hirschfeld

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VALUATION OF SPOUSAL INTEREST IN A PROFESSIONAL PRACTICE FOR EQUITABLE DISTRIBUTION: HIRSCHFELD v. HIRSCHFELD

I. INTRODUCTION

The New York court in Hirschfeld v. Hirschfeld held that under the state’s equitable distribution statute a husband’s interest in his law practice constitutes marital property subject to equitable division upon divorce. The court noted the lack of a valuation standard in both the statute and the state case law and applied an Internal Revenue Service formula to calculate the amount of goodwill in the law practice. The court divided that amount equally and awarded the wife $6,900, over three years, as her share of the husband’s net income from his law practice.

The New York statute concerning distribution of marital property upon divorce is representative of one of the three approaches utilized by the courts in dividing property. Under an equitable distribution approach, the court is vested with equitable power to distribute the marital property among the parties, regardless of legal title, in order to achieve an equitable apportionment. The second method is the common law or title approach wherein the court can only distribute property according to legal title. Under the final method, the community property approach, all property acquired during marriage is held jointly with each spouse possessing a one-half interest. In both the community property and equit-

6. The common law or title approach is recognized in only two jurisdictions: Mississippi and West Virginia. Virginia was the third “title” state until July 1, 1982. Freed & Foster, supra note 5, at 4079.
able distribution jurisdictions where the court is authorized to distribute marital property, questions have arisen concerning whether an interest in a professional practice constitutes marital property divisible upon divorce, and if so, the value which should be placed on this interest.

The determination of whether a wife has a spousal interest in the husband's professional practice usually follows one of two approaches. If the husband has an established professional practice, the wife will seek her share through a determination that the husband's interest in the practice constitutes marital property. If, on the other hand, the husband has only recently obtained his professional degree or license and has not yet established a practice, a wife will seek her share through a determination that the degree or license constitutes marital property subject to division. The Hirschfeld case fell into the first category. Analysis of the second category is beyond the scope of the present article. The determination of whether an interest in a professional practice constitutes marital property and the value which should attach is of current significance in

8. For convenience and clarity, the term "husband" in this article will refer to the spouse engaged in the professional practice; and "wife" will refer to the spouse seeking to participate in equitable distribution. Reversal of the roles would not affect the outcome of the case.


Virginia. In 1982, Virginia abandoned its strict common law view of marital property in favor of an equitable distribution format.\(^{12}\)

This comment will focus on two areas: (1) examination and analysis of *Hirschfeld* and other pertinent case law, and (2) discussion of various valuation methods for determining the monetary value of the spousal interest.

II. **Determination of Spousal Interest in a Professional Practice as Marital Property**

A. **Statement of the Case**

Lee and Howard Hirschfeld were married in 1959. At the time of their marriage the parties possessed little marital property, and their combined income was correspondingly low. Shortly thereafter, Howard established a professional practice as a sole legal practitioner. The parties moved to New York where they settled and raised a family. Howard continued his professional practice in New York; and Lee, in addition to raising the children and being a full-time homemaker, was employed part-time as a travel agent. After being married for over twenty years, Howard abandoned the marital home in 1980. Lee brought suit for a divorce one year later.\(^{13}\)

Lee's petition for divorce was brought pursuant to New York's equitable distribution statute.\(^{14}\) Formerly a strict common law or title state,\(^ {15}\) the New York legislature enacted the equitable distribution statute\(^{16}\) in recognition of the modern view of the marriage relationship as an economic partnership.\(^ {17}\) Under this statute, "property accumulated during the marriage should be distributed in a manner which reflects the individual needs and circumstances of the parties regardless of the name in which such property is held."\(^ {18}\) A threshold issue in *Hirschfeld* was whether Howard's interest in his law practice constituted separate or marital property, as only marital property is subject to equitable

\(^{15}\) Id., Practice Commentary at 33; *Foster, An Explanation of the New York 1980 Equitable Distribution Law*, 6 FAM. L. REP. (BNA) 2651 (July 15, 1980).
\(^{17}\) "The distribution of property upon the termination of a marriage should be treated, as nearly as possible, like the distribution of assets incident to the dissolution of a partnership." *UNIF. MARRIAGE AND DIVORCE ACT*, 9A U.L.A. 91, prefatory note at 93.
distribution.\textsuperscript{19}

The court impliedly held that Howard's interest was marital property\textsuperscript{20} and proceeded to an evaluation of the statutory considerations for an equitable disposition.\textsuperscript{21} Howard earned an average of $67,600 a year; and Lee averaged $5,500. They had been married almost twenty-one years, and while Lee was in good health, Howard suffered from a medical ailment which impaired his ability to work. The marital home was occupied

\begin{itemize}
\item 19. Separate and marital property are defined by statute:
\begin{itemize}
\item c. The term "marital property" shall mean all property acquired by either or both spouses during the marriage and before the execution of a separation agreement or the commencement of a matrimonial action, regardless of the form in which title is held, except as otherwise provided in agreement pursuant to subdivision three of this part. Marital property shall not include separate property as hereinafter defined.
\item d. The term separate property shall mean:
\begin{itemize}
\item (1) property acquired before marriage or property acquired by bequest, devise, or descent, or gift from a party other than the spouse;
\item (2) compensation for personal injuries;
\item (3) property acquired in exchange for or the increase in value of separate property, except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse;
\item (4) property described as separate property by written agreement of the parties pursuant to subdivision three of this part.
\end{itemize}
\end{itemize}
\textsuperscript{N.Y. DOM. REL. LAW \S 236 Part B(1)(c), (d) (McKinney Supp. 1981-1982).}
\item 20. The court's opinion never specifically stated that the husband's interest was marital property. \textit{Hirschfeld, 8 FAM. L. REP. at 2404}. However, this finding was implicit in the valuation of that interest for equitable distribution purposes. In addition, the New York court previously held in the first case under the equitable distribution statute that the husband's interest in a closely-held professional corporation was marital property subject to equitable distribution. Nehorayoff v. Nehorayoff, 108 Misc. 2d 311, 437 N.Y.S.2d 584 (1981).
\item 21. In determining an equitable disposition of property under paragraph c, the court shall consider:
\begin{itemize}
\item (1) the income and property of each party at the time of marriage, and at the time of the commencement of the action;
\item (2) the duration of the marriage and the age and health of both parties;
\item (3) the need of a custodial parent to occupy or own the marital residence and to use or own its household effects;
\item (4) the loss of inheritance and pension rights upon dissolution of the marriage as of the date of dissolution;
\item (5) any award of maintenance under subdivision six of this part;
\item (6) any equitable claim to, interest in, or direct or indirect contribution made to the acquisition of such marital property by the party not having title, including joint efforts or expenditures and contributions and services as a spouse, parent, wage earner and homemaker, and to the career or career potential of the other party;
\item (7) the liquid or non-liquid character of all marital property;
\item (8) the probable future financial circumstances of each party;
\item (9) the impossibility or difficulty of evaluating any component asset or any interest in a business, corporation or profession, and the economic desirability of retaining such asset or interest intact and free from any claim or interference by the other party;
\item (10) any other factor which the court shall expressly find to be just and proper.
\end{itemize}
\textsuperscript{N.Y. DOM. REL. LAW \S 236 Part B(5)(d) (McKinney Supp. 1981-82).}
by Lee and the children. Neither party had any interest in a pension or an inheritance. Lee had served as both a part-time wage earner for the family and a full-time homemaker. She was awarded $245 per week as maintenance. Both parties agreed to divide their personal property by stipulation at trial. Their respective incomes will continue to rise in the forthcoming years, although the exact amount is only conjectural. The extent of Lee's interest in Howard's practice was not subject to easy evaluation, and the retention of the practice intact and free from any claim was economically desirable. Finally, the court noted that goodwill could not ethically be sold for valuable consideration.

Based on these considerations, the court held, among other things, that Lee was entitled to a share of Howard's interest in the law practice. However, the court noted the absence of any standard in either the statute or New York case law for determination of the amount of her share. Citing persuasive authority, the court adopted the formula approach promulgated by the Internal Revenue Service. This method determines the value of a business's intangible assets, such as goodwill, by the capitalization of excess earnings over a reasonable return on tangible assets. Using this method, the court determined the goodwill in Howard's practice to be $13,800 and awarded Lee one-half as her equitable share.

23. The court's decree contained further provisions for the final dissolution of the marriage. Howard was ordered to provide maintenance to Lee in the amount of $245 per week until the marital home was sold, at which time the amount would be reduced to $175. He was ordered to pay $20 per week child support for each child until majority, in addition to educational expenses. Further, he was required to maintain medical insurance on the family and a life insurance policy on his own life to cover the total amount of the divorce decree. Lee was granted exclusive use of the marital home, joint custody of the children, and attorney's fees in the amount of $7,000. Finally, the court advised the parties to voluntarily obtain a Jewish divorce. Id. at 2404.
24. Id. at 2403.
25. Id. at 2403 (citing Levy v. Levy, 164 N.J. Super. 542, 397 A.2d 374 (1978) (court employed the formula approach to determine the value of the husband's interest in his law practice for equitable distribution purposes)).
27. Id.
28. Interestingly, the same court, although a different judge, reached an opposite conclusion in a case decided several weeks later. In Barton v. Barton the court rejected the capitalization formula as an appropriate means of distributing the husband's interest in his law practice under the equitable distribution statute. 8 Fam. L. Rep. (BNA) 2453 (N.Y. Sup. Ct. May 20, 1982). The court cited such factors as the inherent unpredictability of a negligence law practice, the extreme fluctuations in yearly income, the lack of goodwill, and the lack of any direct contributions by the wife to the husband's professional achievement. Nevertheless, the wife was awarded $40,000 or 24% of the husband's net income for one year as her distributive share. Id. This decision seems to limit the application of the capitalization formula to professional practices with stable income patterns and an empirically verifiable asset of goodwill.
B. Case Law

In addition to Hirschfeld, other courts have confronted the question of whether the husband's interest in a professional practice is marital property. By an overwhelming majority, courts have held such interest to be marital property subject to equitable distribution. The courts have typically used one of two methods in arriving at their decision. The first method is the determination that the goodwill of a professional practice is marital property subject to division. The other method is a determination that the practice itself is the marital asset. Although the result is the same under either method, the particular method selected does affect the ultimate valuation method employed.

1. Professional Goodwill as Marital Property

The most well-known definition of goodwill is by Justice Story:

[Goodwill is] the advantage or benefit which is acquired by an establishment beyond the mere value of the capital, stocks, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.

Goodwill as a marital asset has been the subject of many commentaries which uniformly recognize various problems in placing goodwill in such a capacity. First, it is unethical and against public policy to sell the goodwill.

29. The only jurisdiction which has addressed the question of the spouse's interest and refused to recognize the goodwill of a professional practice as property is Texas. Nail v. Nail, 486 S.W.2d 761 (Tex. 1972). See infra text accompanying notes 50-52.


33. See generally Raggio, supra note 9; Comment, Valuation of Professional Goodwill
will of a law firm for valuable consideration.44 Second, goodwill is an inherently intangible asset.36 Third, there is no set standard or rule for determining the existence of goodwill.38 Instead, the question of goodwill is a matter of fact and not of law.37

The courts have promulgated a few guidelines in dealing with goodwill. First, any consideration of goodwill generally cannot be based on future earnings or post-marital efforts.38 Second, the timing of the valuation is the period between the time of marriage and the filing of divorce.39 Finally, it should be "determined with considerable care and caution, since it is a unique situation in which the continuing practitioner is judicially forced to buy an intangible asset at a judicially determined value and compelled to pay a former spouse her share in tangible assets."40

The proposition that the goodwill of a professional practice is marital


34. "An attorney may not purchase the practice and goodwill of a deceased attorney. . . ." ABA Comm. on Professional Ethics, Formal Op. 266 (1945). "A lawyer in private practice shall not practice under a trade name, a name that is misleading as to the identity of the lawyer or lawyers practicing under such name, or a firm name containing names other than those of one or more of the lawyers in the firm. . . ." Va. CODE OF PROFESSIONAL RESPONSIBILITY DR 2-102(B) (1976), reprinted in Va. SUP. CT. R. 6:II, 216 Va. 1064, 1078 (1976). See also Annot., 79 A.L.R. 3d 124 (1977).

However, subsequent case law has made it clear that although the goodwill may not be sold ethically, it is still possible to recognize it as "a real element of economic worth" in determining the value of a professional practice. Stern v. Stern, 66 N.J. 340, —, 331 A.2d 257, 261 n.5 (1975). See also Levy v. Levy, 164 N.J. Super. 542, 397 A.2d 374 (1978).


38. This prohibition is absolute in community property jurisdictions. Since only property acquired during the marriage is community property, it would be inconsistent with the community property philosophy to include the post-marital efforts of either party in the valuation. In re Marriage of Fortier, 34 Cal. App. 3d 384, 109 Cal. Rptr. 915 (1973). Equitable distribution jurisdictions allow its limited use as one factor in arriving at an equitable distribution. Stern v. Stern, 66 N.J. 340, 331 A.2d 257 (1975).


property was first enunciated in dicta in the California case of Mueller v. Mueller. The husband argued that goodwill could not attach to his dental laboratory business because such a business depends solely upon the personal skill and ability of the individual owner. The court stated that the question of whether his practice possessed goodwill was a question of fact. Since the lower court found substantial evidence that his business was not based exclusively upon his own efforts, the court rejected his argument. Therefore, the trial court’s finding of goodwill in the amount of $25,000 was affirmed. Continuing in dictum, the court stated that even if the practice were based solely on his personal skills and abilities, goodwill could nevertheless be attached to his business:

The better doctrine, however, appears to be that goodwill also exists in a professional practice or in a business which is founded upon personal skill or reputation. Where a person acquires a reputation for skill and learning in a particular profession, as, for instance, in that of a lawyer, a physician, or an editor, he often creates an intangible but valuable property by winning the confidence of his patrons and securing immunity from successful competition for their business, and it would seem to be well settled that this is a species of goodwill which may be the subject of transfer.

The dicta in Mueller was relied upon in Golden v. Golden to hold that the goodwill of a husband’s medical practice constitutes a marital asset subject to division upon divorce. The trial court placed a monetary value on the practice, including $32,500 for goodwill. Even though the husband was awarded the goodwill, he was ordered to pay the wife one-half of the total value of the practice. On appeal, the husband attacked the decree on the basis of previous case law holding that no allowance could be made for goodwill upon the dissolution of a professional practice. The court rejected his argument on the grounds that his practice was not being dissolved in the present proceedings. Instead, the court was merely placing a monetary value on the firm’s goodwill for purposes of determining the total value of marital property available for division; and afterwards his business would continue with the same value it had possessed previously. The court held that “the better rule is that, in a divorce case, the goodwill of the husband’s professional practice as a sole

42. Id. at 250, 301 P.2d at 95.
43. Id. at 250-51, 301 P.2d at 94-95 (quoting 24 Am. Jur. Goodwill § 11, at 808 (1939)). The court’s reliance on the legal encyclopedia American Jurisprudence has been criticized because the section from which the quotation was extracted dealt with the sale of a professional practice and not an evaluation for marital dissolution purposes. Lurvey, Professional Goodwill on Marital Dissolution: Is it Property or Another Name for Alimony? 52 Cal. St. B.J. 27, 30 (1977).
44. 270 Cal. App. 2d 401, 75 Cal. Rptr. 735 (1969).
45. Lyon v. Lyon, 246 Cal. App. 2d 519, 54 Cal. Rptr. 829 (1966) (court held that no allowance for goodwill could be made upon the dissolution of a law practice because its value was dependent upon the skill of each partner).
practitioner should be taken into consideration in determining the award to the wife.\textsuperscript{46} The court recognized that the wife is entitled to compensation for her contributions to the husband's earnings and accumulations during the marriage by virtue of her position in the family.\textsuperscript{47}

The decision in \textit{Golden} firmly established the rule that professional goodwill is a marital asset subject to division upon divorce. Subsequent cases have reinforced that finding and differ only on the correct method by which to place a monetary value on the asset.\textsuperscript{48} Although the majority of these cases were decided in community property jurisdictions, similar results have been reached in equitable distribution jurisdictions.\textsuperscript{49}

One jurisdiction, however, has refused to recognize professional goodwill as an asset. In \textit{Nail v. Nail}\textsuperscript{50} the Texas Supreme Court held that the goodwill of a medical practice does not constitute marital property subject to division upon dissolution of marriage. The lower court valued the husband's medical practice at $131,000, inclusive of goodwill. Based upon this finding, the wife was awarded $40,000 as her community interest in the husband's practice.\textsuperscript{51} On appeal, the court reversed the lower court's valuation insofar as it relied on the item of goodwill. The court stated that the goodwill of the husband's practice
did not possess value or constitute an asset separate and apart from his person, or from his individual ability to practice his profession. It would be extinguished in event of his death, or retirement, or disablement, as well as in event of the sale of his practice or the loss of his patients, whatever the

\textsuperscript{46} \textit{Golden}, 270 Cal. App. 2d at 405, 75 Cal. Rptr. at 737.

\textsuperscript{47} \textit{Id.} at 405, 75 Cal. Rptr. at 738.


The case law from the community property jurisdictions, however, should not be disregarded in a proceeding under an equitable distribution statute. The cases should be offered as persuasive authority for holding professional goodwill subject to distribution. Grossman, \textit{supra} note 5, at 218.

\textsuperscript{50} 486 S.W.2d 761 (Tex. 1972).

\textsuperscript{51} \textit{Id.} at 761-62.
cause. . . . The goodwill of the husband's medical practice . . . may not be characterized as an earned or vested right or one which fixes any benefit in any sum at any future time. That it would have value in the future is no more than an expectancy wholly dependent upon the continuation of existing circumstances. Accordingly, we hold that the good will of petitioner's medical practice that may have accrued at the time of the divorce was not property in the estate of the parties. . . .

The holding in *Nail* has been severely criticized, mainly on the basis of its reasoning. However, the application of its holding must also be criticized for producing inequitable results; a wife who has made substantial contributions to the husband's career may be denied her rightful share of the fruits of her labor. The precedential value of *Nail* has been diminished by subsequent decisions. The Texas court later recognized the existence of goodwill in a professional corporation as opposed to a sole practitioner. In addition, a decision from another jurisdiction has stated that the concept of vesting is inapplicable to equitable distribution of marital property upon divorce.

2. Professional Practice as Marital Property

The second method utilized by the courts to distribute the husband's interest in his professional practice is to find that the practice itself constitutes marital property. However, this does not mean that the husband must sell the practice or admit the wife as a silent partner in order to achieve an equitable distribution. New York is representative of many states which have provided for a monetary or distributive award that provides the wife with her share of the practice, while having no impact on the professional practice itself. The husband's practice continues unin-

52. Id. at 764.
53. E.g., *Identifying Professional Goodwill*, supra note 33, at 319-22 (criticizing the court's reliance on the question of whether the practice's goodwill was a vested property interest).
54. E.g., *Stephens v. Stephens*, 625 S.W.2d 428 (Tex. Ct. App. 1981) (The professional goodwill of the husband's medical practice was disregarded as an asset subject to division even though the wife put him through medical school, worked in his business, and continued working outside the home once his practice was established.).
55. *Geesbreght v. Geesbreght*, 570 S.W.2d 427 (Tex. Civ. App. 1978). *Nail* was distinguished on the grounds that the professional corporation was not based on the individual services of the husband. Id. at 434.
57. The New York statute provides:

In any action in which the court shall determine that an equitable distribution is appropriate but would be impractical or burdensome or where the distribution of an interest in a business, corporation or profession would be contrary to law, the court in lieu of such equitable distribution shall make a distributive award in order to achieve equity between the parties. The court in its discretion, also may make a distributive award to supplement, facilitate or effectuate a distribution of marital property.

Although the court in *Hirschfeld* held that the professional practice of a sole practitioner was a marital asset subject to distribution, other forms of professional practices are also capable of classification as marital property. The Illinois court in *In re Marriage of White* held that the husband's interest in a professional corporation was marital property. The wife had appealed the lower court's division of marital property on the grounds that the husband's professional dental corporation was not included. The court reversed the decree and held a professional corporation was included within the definition of property under that state's equitable distribution statute. The court stated: "[W]e [do not] perceive any economic or public policy reason why a professional corporation should not be treated as marital property subject to disposition by the court." Similar decisions have held that interests in professional partnerships and closely-held professional corporations are also marital property.

III. Valuation Methods

Once the husband's interest is determined to be marital property subject to equitable distribution, the court must place a monetary value on the spousal interest. This monetary value is then subject to equitable distribution. Since there is no standard formula, each court has employed its own methodology in valuating spousal interest in a professional practice, resulting in the use of various valuation methods.

A. Accounting Formulas

According to accounting principles, goodwill is the earnings in excess of a fair rate of return on the tangible assets of a business. The Internal Revenue Service has recognized several methods of placing a monetary

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value on goodwill, the most common of which is the formula approach.\textsuperscript{66} The monetary value under this method is determined by taking the average annual income of the business\textsuperscript{67} and subtracting an appropriate rate of return for the tangible assets. The remaining amount is the average annual income produced by the intangible asset of goodwill. The monetary value of the business' goodwill is then determined by capitalizing this amount at an appropriate rate.\textsuperscript{68} The theory behind the formula approach is that the asset of goodwill represents a future flow of income which can be reduced to its present value in the form of a lump sum payment.\textsuperscript{69} The formula approach is an appropriate valuation method only if no better basis is available for determining the value of goodwill.\textsuperscript{70}

The court in \textit{Hirschfeld} adopted the formula approach to determine the monetary value of Howard's interest in the law practice. However, the

\textsuperscript{66} 1981 STAND. FED. TAX. REP. (CCH) ¶ 4460.2995. The first accounting formula for valuating goodwill is the straight capitalization method. This method capitalizes the average net profits of a business at a particular rate. The resulting value is the total value of the business, including the values of both tangible and intangible assets. The second accounting formula is the three-or five-year purchase method. A specified rate of return is allowed on the tangible assets of a business. This return is subtracted from the average profits, and the remainder is multiplied by either three or five, depending on which plan is used, to determine the amount of goodwill. However, the first two methods are rarely used by the courts because of the arbitrary manner in which value is assigned to goodwill. \textit{Valuation of Goodwill}, supra note 33, at 194. The final accounting formula is the income tax method, also known as the formula approach or the capitalization of excess earnings. The monetary value of goodwill is determined by the following method:

A percentage return on the average annual value of the tangible assets used in a business is determined, using a period of years (preferably not less than five) immediately prior to the valuation date. The amount of the percentage return on tangible assets, thus determined, is deducted from the average earnings of the business for such period; and the remainder, if any, is considered to be the amount of the average annual earnings from the intangible assets of the business for the period. This amount (considered as the average annual earnings from intangibles), capitalized at a percentage of, for example, 15 to 20 percent, is the value of the intangible assets of the business determined under the "formula" approach.

\textsuperscript{67} To determine the average annual income, the earnings from the last five years should be averaged with any abnormally high or low amounts being ignored. If the subject business is a sole practitioner or a partnership, a reasonable amount for salary must be deducted. Rev. Rul. 68-609, 1968-2 C.B. 327, 328.

\textsuperscript{68} The appropriate capitalization rate is dependent upon the facts in each situation. Three factors which influence the determination of the rate are: (1) the nature of the business; (2) the risk involved; and (3) the stability or irregularity of the earnings. The suggested rate for a business with relatively high hazards is a five year multiplier or twenty percent. This rate would be less for a business with a small risk factor and stable, regular earnings. \textit{Id.} at 328.


court actually applied a "modified" formula approach. If the lawyer earns more from his practice than the average salary paid for similar legal services in the industry, then the excess earnings are deemed capital assets.\textsuperscript{71} The wife would then be entitled to an equitable share of that amount. Both Howard and Lee hired expert witnesses to testify as to the amount available for equitable distribution under the formula approach. Predictably, both reached dramatically different results. The wife's expert testified that the husband's average annual net income was $26,323; and the amount available for distribution was $23,707.50. The husband's expert, on the other hand, testified that the husband's average annual net income was only $18,872; and since the average salary for the same services was $20,000 in the corporate industry, there was no goodwill attributable to the practice.\textsuperscript{72} However, the court rejected both valuations and instead substituted its own determination.\textsuperscript{73} The court found that in applying Revenue Ruling 68-609, the average gross earnings of the husband's law practice was $67,600. This amount was reduced by 50\% to account for the cost of overhead,\textsuperscript{74} resulting in an average net income of $33,800. The court subtracted the sum of $20,000 from the net income as the average salary available in a corporate position and determined that the amount available for equitable distribution was $13,800. Accordingly, Lee was awarded $6,900 over three years as her equitable share of Howard's interest in his law practice.\textsuperscript{75}

The formula approach has been applied by other courts to determine the value of spousal interest in a professional practice.\textsuperscript{76} However, the


\textsuperscript{72} Id. The text of the opinion lacks information regarding the methods used by the experts to determine these figures.

\textsuperscript{73} Id. at 2403-04. This action was properly within the discretion of the court under the New York equitable distribution statute. N.Y. Dom. Rel. Law § 236 Part B. (McKinney Supp. 1981-1982).

\textsuperscript{74} The court noted that the average overhead for a single practitioner is between 45 and 55\% of gross earnings. One of the reasons for rejecting the husband's valuation was its utilization of a 70\% figure as overhead. Hirschfeld, 8 Fam. L. Rep. at 2404.

\textsuperscript{75} Even though the court divided the net income equally between the husband and wife, a 50-50 division was not mandated by the statute. Id.; Foster, supra note 15, at 2653. The New York statute only requires an equitable division between the spouses. N.Y. Dom. Rel. Law § 236 Part B(5)(c) (McKinney Supp. 1981-1982).

\textsuperscript{76} In re Marriage of Webb, 94 Cal. App. 3d 335, 156 Cal. Rptr. 334 (1979) ($16,000 value for goodwill was determined by a combination of capitalization of excess earnings and market value); Mueller v. Mueller, 144 Cal. App. 2d 245, 301 P.2d 90 (1956) (court upheld valuation of goodwill at $25,000 under two methods, one of which was a capitalization of excess earnings); Levy v. Levy, 164 N.J. Super. 542, 397 A.2d 374 (1978) (court applied Revenue Ruling 68-609 but found no goodwill because the average earnings were less than average salary in the industry); Hurley v. Hurley, 94 N.M. 641, 615 P.2d 256 (1980) (court held that the capitalization of excess earnings was a proper method to determine value of a professional practice). But see Ellsworth v. Ellsworth, 97 N.M. 133, ___, 637 P.2d 564, 566 (1981) (court overruled Hurley to extent it "would preclude any consideration of the community
application in *Hirschfeld* differs substantially due to its failure to apply a multiplier. When the court subtracted the average salary from the net income, the remaining amount was not the amount of goodwill available for distribution, but the average annual income produced by the goodwill. In order for the court to arrive at the value of goodwill, that amount should have been capitalized by an appropriate rate or number of years. The court in *Levy v. Levy* stated that the appropriate multiple would "vary inversely with the amount and intensity of competitiveness in the line of business being appraised." The court in *Nehorayoff v. Nehorayoff* held that the multiplier for a closely-held medical corporation was between three and four. In addition, the court in *Mueller v. Mueller* applied a capitalization rate of three to a dental laboratory business. By applying the foregoing, the appropriate value of the practice's goodwill available for distribution should have been at least $41,400 ($13,800 multiplied by three). Therefore, Lee's share should have been $20,700 instead of $6,900.

property awarded to a spouse in reaching an equitable award of alimony").

77. A multiplier is the number of years after the sale of a business that a purchaser will pay the seller for the net profits of the business. *Community Property Valuation*, supra note 69, at 446 n.74. Under the formula approach, the amount of income produced by goodwill is capitalized or multiplied by the number of years of the multiplier. This results in the monetary value of the goodwill. The court in *Hirschfeld* either applied a multiplier of one, in which case the monetary value of the goodwill would not have changed, or no rate at all. The facts as reported in the opinion are insufficient to determine which is the correct interpretation. *Hirschfeld*, 8 FAM. L. REP. at 2404.

The court also failed to deduct a reasonable return on the tangible assets of the business from the average annual income. Again there are insufficient facts as to the court's reasoning. *Id.* One possible reason is that a law practice is based on the personal services of the lawyer, and as such, the amount of tangible assets is negligible.


79. *Id.* at —, 397 A.2d at 380.


81. 144 Cal. App. 2d 245, 301 P.2d 90 (1956). This capitalization rate was not explicitly stated in the opinion. However, it is determined by implication through an analysis of the court's holding. See *Valuation of Goodwill*, supra note 33, at 195 n.51.

82. The following hypothetical illustrates the application of the formula approach: Suppose the professional spouse has had an average annual income over the last five years of $50,000. In addition, suppose that he or she has tangible assets in the professional practice worth approximately $20,000. On these facts and the values suggested in Rev. Rul. 68-609, the value of the goodwill is determined as follows:

<table>
<thead>
<tr>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average annual income</td>
<td>$50,000</td>
</tr>
<tr>
<td>- Return on tangible assets (10%)</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Average annual income produced by goodwill</td>
<td>48,000</td>
</tr>
<tr>
<td>- Average salary in same profession</td>
<td>(45,000)</td>
</tr>
<tr>
<td>Excess earnings</td>
<td>3,000</td>
</tr>
<tr>
<td>x Capitalization</td>
<td>5</td>
</tr>
<tr>
<td>Value of intangible asset of goodwill</td>
<td>15,000</td>
</tr>
</tbody>
</table>
The formula approach is generally considered to be the best method, where appropriate, for valuing the spousal interest in professional practices. It is an accurate measurement of true value and is commonly used and understood by the court and expert witnesses. However, the formula approach does suffer from several disadvantages: (1) it is only appropriate where no better method of valuation is available; (2) expert witnesses are frequently unable to adequately explain its theoretical basis; (3) it is difficult to determine an average salary for similar services; (4) it is difficult to choose an appropriate multiplier; and (5) it can sometimes lead to unpredictable results. To solve these problems, commentators have suggested discounting to present value and averaging the results of several formulas.

B. Alternative Valuation Methods

In situations where accounting methods are not appropriate, the court must apply alternative valuation methods to determine the value of the husband’s interest in his professional practice. The first alternative is the market value method, which “sets a value on professional goodwill by establishing what fair price would be obtained in the current open market if the practice were sold.” The market value method is favored by the courts over all other methods when available because of its accuracy. However, this method has two disadvantages: (1) it is unethical and against public policy to sell the goodwill of a law practice; and (2) the market value approach is based in part upon the post-marital efforts of the parties.

83. Raggio, supra note 9, at 154; Identifying Professional Goodwill, supra note 33, at 341.
84. Raggio, supra note 9, at 154; Identifying Professional Goodwill, supra note 33, at 334.
85. See supra text accompanying notes 65-70.
86. Identifying Professional Goodwill, supra note 33, at 334.
87. Community Property Valuation, supra note 69, at 447.
88. E.g., In re Marriage of Fortier, 34 Cal. App. 3d 384, 109 Cal. Rptr. 915 (1973) (Court adopted the husband’s valuation of practice’s goodwill as $10,963 on basis of market value and rejected wife’s valuation of $294,333 based on capitalization of excess earnings).
89. Valuation of Goodwill, supra note 33, at 203-05.
90. Identifying Professional Goodwill, supra note 33, at 334.
91. See supra text accompanying note 69.
92. See In re Marriage of Fortier, 34 Cal. App. 3d 384, 109 Cal. Rptr. 915 (1973) (Court held that the value of goodwill of the husband’s medical practice was the market value at which it could be sold.).
93. Identifying Professional Goodwill, supra note 33, at 334.
94. Valuation of Goodwill, supra note 33, at 201.
95. Valuation of Goodwill, supra note 33, at 200. Thus, it is unlikely there will be a predetermined value, at least for a law practice; and “no readily available market exists upon which to gauge the practice’s value.” Id. In re Marriage of Lopez, 38 Cal. App. 3d 93, 109-10, 113 Cal. Rptr. 58, 68 (1974). See also In re Marriage of Foster, 42 Cal. App. 3d 577, 117 Cal. Rptr. 49 (1974); In re Marriage of Lukens, 16 Wash. App. 481, 558 P.2d 379 (1976).
96. Valuation of Goodwill, supra note 33, at 200; see also Identifying Professional Good-
The second alternative method involves analysis of the provisions of buy-sell agreements. The value of goodwill under this method is the predetermined amount stipulated by the parties in either a partnership agreement or an unexercised option, designating the interest of each partner in the practice. This amount coupled with the value of the husband's capital assets results in a presumptive value of the interest in the professional practice which can be attacked only by clear and convincing evidence. Before such a method can be used reliably, it must be shown that the values are subject to periodic and careful review. However, the amount contained in the buy-sell agreement is not binding upon the court.

A third alternative method is that of Revenue Ruling 59-60, which concerns the valuation of assets of a closely-held corporation for federal estate and gift tax purposes. Valuation of the husband's interest in his professional practice is accomplished through an analysis of:

(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 the stock and the size of the block of stock to be valued.
(h) The market price of stocks of corporations engaged in the same or similar line of business having their stocks actively traded in a free open market, either on an exchange or over-the-counter [basis].

Although this method was previously used only for federal tax purposes, it has been adapted to the valuation of assets for marital property disso-

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98. Id. at 331 A.2d at 261. See also Grayer v. Grayer, 147 N.J. Super. 513, 371 A.2d 753, 757 (1977) (court refused to rely on the amount in the partnership agreement for valuation purposes because it had not been reviewed periodically).
99. See In re Marriage of Slater, 100 Cal. App. 3d 241, 160 Cal. Rptr. 686 (1980) (court was not bound by the amount in the agreement which was determinative of husband's contractual withdrawal rights and not his interest in the partnership); In re Marriage of Morris, 588 S.W.2d 39 (Mo. Ct. App. 1979) (court was not restricted to valuation methods in stock redemption agreement because neither method contemplated valuation for marital dissolution purposes); In re Hayden, 5 Fam. L. Rep. (BNA) 2526 (Wash. Ct. App. June 18, 1979) (agreement providing for no goodwill was only binding among the partners and not on the court).
A final method recognized by the courts is a valuation based on several specific factors. If the goodwill of the professional practice is the marital asset subject to distribution, this method requires its value to be determined by an examination of:

1. the age and health of the practitioner;
2. his professional reputation;
3. the nature and duration of the business;
4. the value of tangible and intangible assets;
5. past earning power;
6. and comparative business success.

If the husband’s interest in the professional practice itself is the subject of distribution, its value must be determined by an examination of:

1. capital accounts and investments;
2. fixed and miscellaneous assets, including accounts receivable, costs advanced, work in progress, work completed but not billed, cash and partnership life insurance;
3. goodwill;
4. business liabilities;
5. and accrued equity.

The courts applying this method recognize that there is no set rule for the determination of the husband’s interest in the professional practice. Instead, the trial court must examine each factor in the context of a given case to determine the correct value of the interest. The appellate courts will generally recognize any valuation based on these factors as long as the trial court has not relied on future earnings of either party.

The foregoing represent the most common methods employed by the courts to value the spousal interest in a professional practice. No one particular method is best suited for all situations. Instead, the method utilized must reflect the factual situation in each individual case.

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105. Other less common methods of valuation of goodwill include the use of a percentage of one year’s average gross income, Mueller v. Mueller, 144 Cal. App. 2d 245, ___, 301 P.2d 90, 95 (1956); Barton v. Barton, 8 FAM. L. REP. (BNA) 2453 (N.Y. Sup. Ct. May 20, 1982), and the use of the Uniform Partnership Act to determine the value of spousal interest, Riegler v. Riegler, 243 Ark. 113, 419 S.W.2d 311 (1967) (discussing UNIF. PARTNERSHIP ACT § 25.28, 6 U.L.A. 5 (1969)).
IV. IMPLICATIONS FOR VIRGINIA LAW

Effective in 1982, Virginia abandoned its strict common law or title view of marital property and adopted an equitable distribution statute. The court is given three duties under the statute to insure an equitable division of marital assets. The court must determine: (1) which property is subject to equitable distribution; (2) the value of the marital property; and (3) the equitable apportionment of the marital assets in


[t]he primary thrust of this section is to recognize marriage as a partnership to which each party contributes, albeit not always equally, to the well-being of the family unit. These contributions, both monetary and nonmonetary, have value and should be weighed, along with other factors, in allocating marital assets or their dollar equivalent between the parties when they are divorced or their marriage is dissolved.


108. The statute divides property into two categories—marital and separate. While marital property can be the proper subject of equitable distribution, the court has no jurisdiction over separate property. Separate property is defined as:

(i) all property, real and personal, acquired by either party before the marriage;
(ii) all property acquired during the marriage by bequest, devise, descent, survivorship or gift from a source other than the other party; and
(iii) all property acquired during the marriage in exchange for or from the proceeds of sale of separate property, provided that such property acquired during the marriage is maintained as separate property. Income received from, and the increase in value of, separate property during the marriage is separate property.


Marital property is defined as:

(i) all property titled in the names of both parties, whether as joint tenants, tenants by the entirety or otherwise, and
(ii) all other property acquired by each party during the marriage which is not separate property as defined above. All property acquired by either spouse during the marriage is presumed to be marital property in the absence of satisfactory evidence that it is separate property.

Id. § 20-107.3(A)(2).

109. The statute provides a list of factors which the court must consider in determining the amount of the award and its method of payment. These factors are:

1. The contributions, monetary and nonmonetary, of each party to the well-being of the family;
2. The contributions, monetary and nonmonetary, of each party in the acquisition and care and maintenance of such marital property of the parties;
3. The duration of the marriage;
4. The ages and physical and mental condition of the parties;
5. The circumstances and factors which contributed to the dissolution of the marriage, specifically including any ground for divorce under the provisions of § 20-91(1),(3) or (6) or § 20-95;
6. How and when specific items of such marital property were acquired;
the form of a monetary award.\textsuperscript{110}

The enactment of this statute raises the question of whether spousal interest in a professional practice is marital property in Virginia, and if so, how it should be valued. The Virginia courts should recognize spousal interest in a professional practice obtained during the marriage as marital property subject to division. This proposition is based on an analysis of the case law and statutory definition of marital property. However, the Virginia courts will be confronted with the same problem which faced the \textit{Hirschfeld} court. The statute fails to provide a standard by which this interest is to be valued, and there is no Virginia case law on point. In situations where there is extrinsic evidence of a firm's value, as in a recent purchase, the courts should adopt the market value method to determine the appropriate value.\textsuperscript{111} Where such evidence is not available, the court should consider adopting the formula approach promulgated in Revenue Ruling 68-609 by the Internal Revenue Service.\textsuperscript{112} The inclusion of spousal interest in a professional practice as marital property would insure the equitable distribution of all marital assets upon the dissolution of marriage.\textsuperscript{113}

V. Conclusion

The New York court in \textit{Hirschfeld v. Hirschfeld} held that a spouse's interest in a professional practice is subject to equitable distribution. This holding reflects the modern view of the marriage relationship as a partnership. Each party contributes both monetarily and nonmonetarily...
to the acquisition of marital assets, and equity requires the distribution of these assets upon the dissolution of the marriage. The Virginia courts should recognize spousal interest in a professional practice as marital property under its equitable distribution statute. However, the valuation of that interest will continue to present problems because there are no concrete objective formulas available. Instead, each case must be determined upon its own peculiar facts with the appropriate valuation method then being applied.

David W. Hagy