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APPLICATION OF THE "VALUE TO THE OWNER" APPROACH and THE IMPORTANCE OF THE DECISION IN "WALL and WALL"

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Introduction

The unreported judgment of the Full Court of the Family Court (comprised of Lindenmayer, Kay and Hannon, JJ) in the matter of ***Wall and Wall*** *(EA83 of 1999)* was delivered on 26 October 2000. With the exception of its mention in the Appeal Summaries section of Australian Family Lawyer (Vol 14, No.4), the decision appears to have gone largely unnoticed, despite the fundamental valuation issue that it deals with.

The decision in ***Wall and Wall*** contains an important clarification of the application of the "value to the owner" approach widely adopted by the Family Court and consideration of the potential double counting of a party's business profit as both property and a financial resource.

This paper examines the development of the "value to the owner" concept and its wide application to most valuations before the Family Court in recent years. The paper also considers the significance of the decision in ***Wall and Wall***, together with the professional practice cases ***Best and Best*** *(1993) FLC 92 418* and ***B and B (No 2)*** *(2000) 26 FLR 437*. Finally, the paper also considers whether the leading tax cases as they apply to valuation for the purpose of Family Law Proceedings reconcile with the value to the owner concept.

The "Value to the Owner" approach

Dealing firstly with a review of the decisions from which the value to the owner concept arose, the following cases are relevant.

The appropriateness of the ***Spencer's case*** "hypothetical willing but not anxious purchaser and vendor" principle was first questioned in ***The Marriage of Reynolds*** *(1984) 10 Fam LR 388.*

The matter involved a company in which the husband and his parents were shareholders and a partnership in which the parents, the husband, the wife and the husband's sisters and brothers-in-law were partners. The Full Court upheld the finding of the trial judge that the potential future value to the husband must be taken into account under section 75(2)(o) as it is a "fact or circumstance which .... the justice of the case requires to be taken into account".
The Full Court said:

> *"We are doubtful, however, whether valuation methods which have been developed for commercial purposes are entirely appropriate for the purposes of family law. The present commercial capital value of shares in a proprietary company may not reflect their value to the spouse who either has control after divorce or who stands ultimately to benefit from them or control them after the death of generous parents, as appears to be the case here."*

In ***Hull and Hull*** *(1983) FLC 91-360;* Nygh J. said that it was artificial to value a wife's share in a private company in matrimonial proceedings according to the hypothetical purchaser rule. That rule is only applicable where there is a ready and available market. Where there is a closely held family corporation with restriction on transfer of shares the Court must value the shares on the realistic value they have to the parties. See also the same Judge's decision in ***Bowman and Bowman*** *(1984) FLC 91-574.*

In ***Sapir and Sapir (No 2)*** *(1989) FLC 92-047***,** before the Supreme Court of New South Wales, Young J. was in agreement with the statements made in ***Reynolds and Reynolds*** and ***Hull and Hull*** and concluded that the value of the wife's shareholding in a family company was the value of the shares to the wife, not their commercial value or their value to a hypothetical purchaser.

In ***Sapir*** the wife had a 48% interest in three family companies formed by her parents in which the classes of shares held by the wife were subordinate in rights to the shares held by her parents, who had successive governing directorship rights. In that case, the husband's accountant adopted a discount rate of between 4-6%, whilst the wife's valuer considered that a rate of between 12-16% was appropriate. The discount rate in each case which was said to reflect the fact that the wife was a minority shareholder and, accordingly, she, or any purchaser from her, would have difficulty in realising the capital value of her shares, or being able to resell them at their full asset backing value, whilst her parents were alive.

The learned trial judge in the course of his reasons for judgment took the view that the accountants were valuing two different things. He adopted the basis of valuation propounded by the husband's valuer, that is to say, the value of the shares to the wife, not their commercial value to their value to a hypothetical purchaser.

Similarly in ***Turnbull v Turnbull*** *(1991) FLC 92 258* the appeal Court was in agreement with the approach taken by the trial judge who agreed with the comments made in ***Reynolds, Hull and Sapir*** and who went on to say:

> *"It is not appropriate in the context of Family Law proceedings to value shares in private family companies on the basis of what a hypothetical purchaser may pay for them. Similarly it is quite inappropriate to adopt the approach taken in the revenue and resumption cases.*

I am satisfied therefore in the context of proceedings under the Family Law Act that when a judge is determining the value of shares held by a party in a family company, he must look at the reality of the situation and value the shares on the basis of their worth to the shareholder. Turning to the facts of the present case, the husband's shares can only be valued, in my view, on the basis of their worth to the husband in the context of the Turnbull family as a whole."

In ***Harrison and Harrison*** *(1996) FLC 92-682*, the Full Court (Ellis, Baker and Warnick JJ) again considered that value of shares held by one of the parties in a family company. The Court relied on ***Hull***, ***Turnbull***, ***Reynolds*** and ***Sapir***, and again said:

"the value to be ascribed to shares in a family company must be a realistic one, based upon the worth of the shares to the party himself or herself."

In ***Ramsay and Ramsay*** *(1997) FLC 92-742*, Justice Warnick provided further guidance in relation to the application of the value to the owner concept, and also provided his opinion that experts should not reach conclusions in relation to uncertain matters, that such matters are better left to the Court to decide (for example, the likelihood of a minority shareholder gaining control at some point in the future). The following extracts from the judgment are of relevance:

(83997) *"Not only has it been recognised in many of the cases later cited that (as was recognised in Mallet (supra)), the purpose of valuation identified for Family Court cases differs from that in revenue and taxation cases, but it has also been recognised that the approaches developed for those cases may well be inappropriate for Family Court purposes. It may be however that, as earlier stated, there has been insufficient identification, both by the accountancy profession and by the Courts, of the approaches which are appropriate for Family Court purposes.*

The purpose of the valuation is to ascertain the value of the shares to the shareholding party, "... not their commercial value or their value to a hypothetical purchaser" (Baker J, Turnbull and Turnbull; Turnbull JR, Bald Hills Pty Ltd, Allan Waters Pty Ltd and Apropos Pty Ltd (Interveners) (1991) FLC ¶92-258 at p 78,738) (see also Sapir v Sapir (No 2) (1989) FLC ¶92-047 at p 77,543 -- decision of Young J, Supreme Court of New South Wales; and Harrison and Harrison (1996) FLC ¶92-682 at p 83,087).

In a number of cases in which it was stated that the value to be ascertained was that to the shareholding party, it was also stated that the value must be "realistic", as if these terms are synonymous. If the use of the term "realistic" is seen as simply "shorthand" for the expression "value to the shareholder", then no doubt there is no inconsistency.

It seems arguable however that what is "realistic " (literally taken) may not be the same as the value to the shareholder. The latter is often not the value that can be achieved on sale and also often takes account of a number of assumptions about the receipt of benefits (often not attaching to the shareholding "per se"). Thus it has a strong "notional" aspect, in contrast to the reality of the market. It seems arguable that the concept of "realistic" value to the shareholder ought include a recognition of what can be achieved on sale. Alternatively, such recognition ought be granted some other place in the decision-making process.

It is in this area of tension, between what I suggest is realism and what might be assessed as the value to the shareholder, that the failure to identify factors pertinent to the valuation exercise being undertaken and in particular the failure to identify those factors, the import of which ought be left to the discretion of the Court, causes particular difficulty.

(83999) *I proffer the following observations:*

(a) a question to be answered in each case, and as to which expert evidence may be admissible, is whether there is a market for the shareholding;

(b) if there is a market, evidence of the market value is highly likely to be relevant, even if there is no intention to sell;

(c) it is however, unhelpful for valuations to focus on the lack of a market in establishing a value to the shareholder. Any allowance for lack of realisable value is best made by the Court, in all the circumstances of the case, particularly the presence or absence of other assets which are disposable;

(d) in cases where there are no realisable assets, the lack of market value of the shareholding will usually be critical, not only to the "division" of property, but perhaps even more so, to the orders made;

(e) if, on the facts of the case, there is any prospect of the minority shareholding party gaining control of the company, the question of the probabilities of that event is likely a question for the Court. If that is so, all that the valuers ought be concerned with is the value to the party if he/she gains control, as well of course as the value if the party remains a minority shareholder;

(f) similarly, if there is any issue about them, questions of the probabilities of particular benefits being received by a shareholding party in the future, are likely best left to the Court, but again valuers ought assess the value of the shareholding, both on the basis that the benefit is received and that it is not.

A further judgment of Justice Warwick, ***AJW v JMW** (2002) FLC 93-103* delivered on 11 March 1998, and not reported until 2002, contains an interesting analysis of the meaning of the value to the owner concept, and clearly defines it as an objective of the process not a methodology in itself. The following are relevant extracts from the judgment:

9. The issue is presented as one between a "fair market value" adopted by Mr Calabro and "value to the owner" adopted by Mr Flynn.

10. In my view, that debate is beset by a degree of confusion, largely due to the terminology used, and a failure to adapt definitions appropriately into the field of property division in Family Law.

11. At the foot of p 9 of his first report Mr Flynn said:

"W.0 APPROACH TO VALUATION

Valuation Methodology -- Value to the owner.

This value known as the 'value to the owner' considers and takes into account the additional economic benefits that ownership of the shares confers to the owners which, at the same time, would not enhance the market value of the shares to the purchaser. These benefits arise from special attributes or advantages which are peculiar to the owner and which may not necessarily be available to a potential third party purchaser."

12. In my view, contrary to the heading used by Mr Flynn, this is not a statement of a "methodology", but rather, of an "objective".

13. At the most, the term "value to the owner", as used by Mr Flynn, describes both an objective and one of the consequences of (or reasons for) pursuing that objective, viz the assessment of worth of special benefits to a shareholder.

14. There can be no doubt that the objective of the valuation is to assess the value of the share to the husband (owner) (see Harrison and Harrison (1996) FLC ¶92-682 at p 83,087). That is so whether there are "special benefits" or not, though if there are special benefits, they must be valued in achieving the objective. However, the use of the term "value to the owner" in Family Law property cases, should not be dependent on the existence of special benefits, but rather, as descriptive of the objective of the valuation exercise.

16. Mr Flynn considered "value to the owner" conceptually, as opposed to the <u>*concept*</u> *of "fair market value".*

17. However, his discussion proceeded as if one came to choose the concept of "value to the owner" after satisfying oneself that there was no market for the shares, and therefore no "fair market value". Again, I do not think that position is so. The objective, in cases such as this, is always, as I said above, to assess the value to the owner. Nor is Mr Flynn's basis (namely, the absence of market value), for choosing "value to the owner" consistent with the definition of "value to the owner", propounded by Mr Flynn. As noted, that definition contains within it the reason for its selection, namely, the existence of special benefits.

23. As I indicated in Ramsay v Ramsay (1997) FLC ¶92-742 where there is a market for shares, evidence of market value may well be one and the same as "value to the owner".

24. But where there is no market, it is something of a "non-sequitur" to seek to ascertain "market value".

25. That is not to say, however, that, though Mr Calabro misstated his aim, the methodology he used could not in fact produce a result which represents the "value to the owner", nor that that result could not also equate market value, if there was a market.

26. But the mischoice of "fair market value" as the objective of the valuation may lead the valuer to adopt a methodology which may suit the situation where there actually is a market, but which may not wholly suit that circumstance where there is no market. So, for example, there may be an impetus to deduct realisation costs, as if shares were going to be sold, when in fact, because there is no market, they are not, and can not.

As indicated by the decisions detailed above, the value to the owner concept as adopted by the Court arose from cases concerned with the valuation of minority interests in closely held family companies and the consideration of the value of these interests where the position of control was likely to change at some point in the immediate or long term future.

It is my experience that despite this body of law pertaining to family company cases (where the party holds a minority interest), the value to the owner principle has been broadly applied by the Court as the objective of the valuation process, whether the subject interest is a minority interest, a professional practice, or some other business venture conducted by the party.

At issue in the unreported case of ***Hegarty and Hegarty*** *(SY 3496 of 2002),* before Coleman J, was the valuation of the husband's accountancy practice. The practice was unusual in that the majority of the husband's clients were McDonald's franchisees. The issue of the appropriateness of applying a value to the owner approach was before the Court. While both accountants had applied a super profit approach in determining the value of the husband's practice, their calculation of super profit and the appropriate capitalisation rate were materially different. It was submitted for the wife that the husband's accountant had "misunderstood his task for family law purposes". At paragraph 40 of the judgment, Coleman J states:

> *"In support of that contention, a number of decisions and papers were referred to. The thrust of the submission of Counsel for the wife was accordingly that the value of the shares or interest is their worth to their owner or holder rather than "their commercial value or their value to a hypothetical purchaser" (Sapir v Sapir (No 2))."*

Coleman J ultimately adopted a mix of the evidence of both accountants, using the super profit as determined by the wife's valuer and the capitalisation multiple of the husband's valuer, applying a value to the owner objective per paragraph 50 as follows:

"Commercial concepts of valuation do not adapt readily, or necessarily realistically, to an interest such as that of the husband in Rolins. It must be remembered that the notion of value is ultimately linked to what might be paid or realised for an asset. The classic formulation of the test of valuation of the High Court in Spencer v Commonwealth (1907) 5 CLR 418 has no real application in a case such as the present where there is no suggestion that the husband will attempt to sell his interest in Rolins, or that, if he did so that it would necessarily be saleable, although it is reasonably apparent that there must be a figure at which a potential purchaser would be prepared to take the risk of retaining sufficient of the husband's current client base to justify paying a sum of money for the opportunity to do so and acquiring his interest in the tangible assets of the practice. Clearly, by having an established practice, a client base, and infrastructure which enables him, albeit only as a consequence of hard work and long hours to do so, an income stream, must be worth something to the husband. Not surprisingly, neither expert suggested anything analogous to the "comparable sales" upon which real estate valuation practice is so heavily reliant, and thereby generally reliable. Having regard to the authorities, it is difficult to reject the notion that, if only for want of a better approach, the value of the husband's interest in Rolins should be seen as the value of the interest to him, albeit that somewhat subjective exercise must be undertaken in the most objective way possible. The authorities leave little doubt that, however theoretical the value of an interest, the interest itself is "property" within Part VIII of the Act. It is, realistically, at the capitalisation stage that the factors which determine the real value of the entity to the husband assume critical significance. Even then, the "value" determined only becomes available to the husband if he sells his asset, and ceases to have the income which it produces, albeit he would retain the skills which enabled him to maintain the value of such interest prior to its sale."

Is there a distinction to be made between the "family company" cases and other matters which may involve a professional practice or business venture conducted by one of the parties?

Professional practices

The valuation of professional practices is considered in cases such as ***Best and Best*** (1993) FLC 92 418 and ***B&B (No 2)*** (2000) 26 FLR 437. While the judgments in the reported cases focus predominantly on whether the subject partnership interest is property under section 79, they also contain discussion on the appropriate valuation methodology.

While a generally accepted approach to the valuation of a professional practice is the capitalisation of super profits (being those profits generated by the practice over and above a return to the principal for his effort in the practice and a return on his net investment in practice assets) there is a very different approach taken by the Court as to the acceptability of this approach in ***Best and Best*** (where is was applied) and the later decision in ***B&B*** (where it was rejected). I note however that valuation methodology was not challenged on appeal in ***Best*** and therefore the Full Court made no comment as to the appropriateness of the method applied (see para 88 of ***B&B***).

In ***B&B***, the interest in the legal practice held by the husband was incapable of assignment and the practice was very clearly a "no goodwill" practice. On exit from the practice, the partners were entitled to their capital and current account balances and a share of work in progress increments. The valuer for the wife applied a capitalisation of super profits approach, and for various reasons as set out in the judgment, his valuation was not accepted by the Court. The valuer for the husband considered the value of the husband's current and capital accounts and also considered whether there was any value under a capitalised super profit approach.

Due to a large variance in the allowance for the salary of the husband ($250,000 v $750,000) the super profit valuation of each of the valuers was materially different. The valuer for the husband in fact found that the super profits earned by the husband were Nil. Furthermore, the accountant stated that in the particular case the adoption of an approach of "**value to a party**" did not provide legitimate support for the application of a super profits methodology in determining the value of property represented by the husband's interest in the partnership. The accountant concluded that it was inappropriate to use the "value to the party" approach to support a super profit methodology because the interest was not assignable in the hands of the husband, any other partner, or any other person. The interest had no greater value in the husband's hands. The Court accepted this evidence.

The facts in ***B and B*** may distinguish it from other cases, in that the husband was at the top of his profession, regarded by his peers as "virtually irreplaceable", and the structure of the partnership was such that his interest could not be disposed of. The appropriateness or otherwise of the super profit approach became a moot point as the evidence of the preferred accountant was that there was no super profit. Interestingly, Moss J makes comment that the Full Court in ***Best*** "decided nothing with respect to the valuation of that partnership interest", because there was no challenge on appeal to the determination of the value by the trial judge. It was disappointing therefore that the issue became irrelevant in the context of ***B and B,*** as no further opinion was offered by the learned judge as to the appropriateness of the super profit approach.

It is my experience that the majority of professional practice valuations undertaken for Family Law purposes utilise the super profit approach, supported by the value to the owner objective. At risk is the potential double count of a professional's capacity to derive income, as both a capitalised value in the property pool and a future financial resource.

I have seen many valuations (legal, medical and accounting practices) where, in the interests of arriving at the “value to the owner”, the super profit generated by the professional has been capitalised without regard to whether the resulting goodwill is personal to the professional or associated with the practice name, location, longevity of the practice, etc, in which case it may be commercial.

This issue of the character of the goodwill is not, in my opinion, considered with any degree of clarity in the cases already referred to.

Wall and Wall

In my opinion, the decision in ***Wall and Wall*** is important as it examines the distinction between personal and commercial goodwill and also considers the potential double count between earning capacity and capitalised value.

The decision represents somewhat of a reality check on the blanket application of an approach under the guise that it provides the best representation of the value to the owner. Furthermore, the subject interest was neither a minority interest nor a traditional professional practice, and the decision therefore has important application to many businesses, whether they be professional practices or otherwise.

Background

An appeal was made by the husband from orders made by the trial Judge, Cohen J. At issue was the value applied to the business conducted by the husband (in particular the value ascribed to goodwill), and other issues pertaining to a boat and contribution (which are not relevant to this discussion).

The husband was a film producer and operated his own business through a company "Off The Wall Pictures Pty Ltd", of which he and his current de facto wife were the only and equal shareholders. It was claimed that business relied entirely on the skills of the husband and Ms Lee.

The trial Judge concluded that the value of the husband's 50% shareholding in the business was $55,043, and in determining the value of the company included an amount for goodwill of $102,000.

As set out at paragraph 32 of the Full Court judgment, the trial judge rejected the argument advanced for the husband that, "……because the business [of the company] relies wholly on the skills of the directors [the husband and Ms Lee], the goodwill is worth nothing and that, in reality, the business is merely a resource which is a manifestation of their earning capacity rather than property" At paragraph 100 of the first instance judgment, his Honour said:

> *"The simple fact is that the husband and Ms Lee have chosen to operate the business through the medium of a company in which they own shares. The husband's share is property. It has to be valued. Its value is to be ascertained in the husband's hands. The goodwill is, in any event, a manifestation of only two years super profitability and not the income of the husband for the rest of his working life in it. The husband's earning capacity is quite a different thing from the value of the goodwill of the business. It is not double counting to rely on both the goodwill for the purpose of s.79 and the husband's earning capacity for the purpose of s.75 (2)."*

The husband challenged the trial Judge's valuation of his share under three elements. The first element related to the trial Judge's acceptance that the company had any goodwill to value. The second related to the finding that the husband's share had any value of significance "in the husband's hand". The third related to certain add backs that were made in determining maintainable super profit.

The Full Court judgment

The Full Court accepted the trial Judge's statement that the value to be ascertained in relation to the husband's share in the company is its value "in the husband's hand's", with authority found in *Turnbull & Turnbull*, *Sapir v.Sapir (No.2)* and *Harrison & Harrison.* Furthermore, the Full Court found that it was open to the trial Judge to reject the submission that because the business relies wholly on the skills of the directors the goodwill is worth nothing, as follows:

> *67 "Such a proposition ignores the fact that "goodwill" in relation to a business may attach to such features as the business name or its location, and many small businesses, which rely entirely on the skills of their operators (eg. Professional practices) are considered to have some goodwill. As Mr Bell said in his report [70] "….. an ordinary person prefers taking over an existing business, rather than setting up a new business". Certainly, an important aspect of that is the set up of an existing business, which would usually include its tangible assets, and possibly some intangible assets other than goodwill, but the mere fact that a business name and clientele who habitually resort to, is, or at least may be, an intangible asset (categorised as "goodwill") of some value. As Wayne Lonergan says [71]:-*
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>> *"The reality is that goodwill exists because a business has a demonstrated capacity to earn cash flows exceeding the cash flow which one would normally expect if one were to invest the same level of tangible and identifiable intangible net assets in a similar business starting from scratch."*

However, the Full Court rejected the approach taken by the trial Judge in valuing the goodwill of the company at $102,000:

68. At the same time we think it was important for his Honour to recognise what is really adverted to in the evidence of Mr Bell, particularly the statement quoted in paragraph 62 hereof, and in his oral evidence quoted in paragraph 64 hereof, namely that there is a significant element of personal goodwill attaching to both the husband and Ms Lee in this case, which is clearly not transferable, and which, in the case of the husband at least, is ***really part of his earning capacity rather than property****.*

69. The difference between commercial and personal goodwill is described, thus, by Lonergan, with particular reference to the valuation of professional partnership partnerships:-

> *"The goodwill of professional practices may be attributable to the combined personal attributes of the partners which revolves around their skills, reputation and personal relations between each other and their clients. Alternatively it may reflect commercial goodwill which relates to their clients' favourable attitudes towards the practice as a whole.*
>
> *This favourable attitude may have been gained through the reputation of the firm or through prior connections and dealings with the firm.*
>
> *The value of commercial goodwill is reflected in the advantages that a prospective partner would obtain by entering into a practice with a recognisable name, established clientele, a range of services, research and precedent databases, well trained staff and recognised programmes and procedures. Personal goodwill attaches to the individual and is attached to that person's own ability, skills, experience, training and reputation. As a general rule personal goodwill is likely to be disproportionally higher than commercial goodwill in a sole practice or small specialist practice of say two or three partners whereas commercial goodwill is likely to be of more value in a larger practice trading under a well recognised name or national or international affiliation."*

> *70. With respect to his Honour, we think that in saying, as he did (in paragraph 100) that "the husband's earning capacity is quite a different thing from the value of the goodwill of the business", he failed to appreciate the important distinction between commercial goodwill and personal goodwill and failed to have regard to that evidence of Mr Bell to which we have referred in paragraph 68 hereof. In valuing the goodwill of the business as he did, we think that his Honour effectively treated the personal goodwill attaching to the husband as part of the commercial goodwill attaching to the business, and this resulted in the adoption of a grossly inflated value for the business, for the company and for the husband's share in the company.*

In considering the second element of the appeal in relation to the value of the share in the company, in relation to the value of the share in the husband's hand, the Full Court said:

> *74. We think it was open to his Honour to find that the husband's share had <u>some</u> value in his hands because it conferred on him <u>some</u> benefits which he could not have obtained as a sole trader (eg., the benefit of Ms Lee's input into the company of which she too was a shareholder, and the benefits flowing from the continued use of the company name and reputation, in the conduct of the business, rather than in his own or some other name which he might need to adopt and take time to attract clients to). However, we do not think that it was open to his Honour to place a value on that share in the husband's hands by simply capitalising the adjusted net profits of the business, adding the value of the net tangible assets, and dividing it by two because the husband was a 50% shareholder in the company. As we have said above, to do so involves attributing entirely to the business whatever personal goodwill attaches to the husband which, on any view, would be substantial in this case.*

The appeal was allowed, relevant parts of the trial Judge's orders were set aside and directions were given for the filing of written submissions.

Therefore, while still having the objective of arriving at the "value to the party", the Full Court has made a clear distinction between the value of commercial goodwill and personal goodwill and earning capacity versus property.

In applying a value to the owner objective it is therefore necessary to carefully consider the appropriate methodology and also the origins of any resulting goodwill. A clear distinction needs to be made between personal and commercial goodwill together with an appropriate allocation of an income stream between property and financial resources. Where commercial goodwill exists and is appropriately valued using a super profit approach, care must be taken not to double count the profit cashflow as both property and a financial resource. The resource in these instances should be the notional salary allowed for the proprietor, not the profit from the business activity.

Tax and the value to the owner objective

Finally, is there consistency between the value to the owner objective and the authorities on tax and realisation costs?

It would be fair to say that there has been a long running debate as to whether tax and other realisation costs should be deducted when determining the value of a party's business interests for the purpose of family law proceedings.

Following the decision of Nicholson CJ in ***Carruthers v Carruthers*** *(1996) FLC 92-707* the widely adopted practice has been to make an allowance for tax and other realisation costs where the asset is likely to be disposed of or the orders of the Court will cause a disposal. Furthermore, a valuation undertaken on the basis of the realisable value of net assets should ordinarily include an allowance for tax and realisation costs.

The decision of the Full Court in ***Rosati v Rosati*** (1998) FamCA 38 affirmed the trial judge's approach of not making a specific allowance for capital gains tax when determining the value of the property pool, rather the possibility of CGT arising was taken into account as a s 75(2) factor, at para 6.44:

> *"this is not a case in which we think the evidence was so clear, and the prospects of a sale of the entire business in the short term so likely, that in the absence of an order for its sale it was an error not to make such an allowance. Rather we think that it was within the proper exercise of His Honour's discretion to take the prospect of such a tax being incurred by the husband into account as a relevant Section 75(2) factor, as His Honour said that he did, and as we have no doubt that in fact he did."*

The judgment in *Rosati* (para 6.36) contains a succinct analysis of the reported decisions prior to that case:

> *It appears to us that although there is a degree of confusion, and possibly conflict, in the reported cases as to the proper approach to be adopted by a Court in proceedings under s 79 of the Act in relation to the effect of potential capital gains tax, which would be payable upon the sale of an asset, the following general principles may be said to emerge from those cases:--*
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> *(1) Whether the incidence of capital gains tax should be taken into account in valuing a particular asset varies according to the circumstances of the case, including the method of valuation applied to the particular asset, the likelihood or otherwise of that asset being realised in the foreseeable future, the circumstances of its acquisition and the evidence of the parties as to their intentions in relation to that asset.*

> *(2) If the Court orders the sale of an asset, or is satisfied that a sale of it is inevitable, or would probably occur in the near future, or if the asset is one which was acquired solely as an investment and with a view to its ultimate sale for profit, then, generally, allowance should be made for any capital gains tax payable upon such a sale in determining the value of that asset for the purpose of the proceedings.*
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> *(3) If none of the circumstances referred to in (2) applies to a particular asset, but the Court is satisfied that there is a significant risk that the asset will have to be sold in the short to mid term, then the Court, whilst not making allowance for the capital gains tax payable on such a sale in determining the value of the asset, may take that risk into account as a relevant s 75(2) factor, the weight to be attributed to that factor varying according to the degree of the risk and the length of the period within which the sale may occur.*
>
> *There may be special circumstances in a particular case which, despite the absence of any certainty or even likelihood of a sale of an asset in the foreseeable future, make it appropriate to take the incidence of capital gains tax into account in valuing that asset. In such a case, it may be appropriate to take the capital gains tax into account at its full rate, or at some discounted rate, having regard to the degree of risk of a sale occurring and/or the length of time which is likely to elapse before that occurs.*

I note that the second limb of the Rosati principles, regarding the nexus between the purpose of the asset holding and an allowance for tax, was onerously applied in ***JEL and DDF** (2001) FLC 93-075.* While it was clear that certain assets had been acquired with a view to making a profit, and all of the assets were valued on a net assets basis, the uncertainty about the timing of such liabilities crystallising led to only a partial allowance being made.

I am concerned that the cases regarding the valuation of an equity interest, be they the minority interest cases, professional practice cases or ***Wall and Wall*** prescribe an approach that arrives at the value of the interest to the party, regardless of whether that value can be achieved by the party at the present time.

For example, the minority interest cases may be said to justify a lower than market minority discount rate (and thus resulting in a higher value of the interest), to allow the special value of the shares to the party to be determined. The party may have no way of actually achieving the value arrived at under such an approach, rather they have to enjoy the benefits of ownership over an extended period, or wait for the demise of their parents (see ***Georgeson and Georgeson*** *(1995) FLC 92-618*).

Similarly, a party may conduct a professional practice, in which the goodwill is commercial, and despite having no intention to realise the interest in the practice, the value is determined applying a capitalisation of super profit approach. As detailed in ***Hegarty,*** the husband's interest in the accounting practice was valued using a super profit approach, yet he had no way of funding the lump sum payment required to be paid to the wife.

The asset valuation approaches do not take into account any discount to reflect the time period over which the asset will be realised (with the exception of the approach in ***Georgeson***), yet the approach to tax as detailed in ***Rosati*** contemplates a relatively immediate imposition of tax, otherwise it is dealt with as a 75(2) factor rather than being deducted from the pool.

I am therefore of the opinion that further consideration of the equity between the approach to valuing an asset and the deduction of tax and other realisation costs should be made. If the value of an asset cannot be achieved without crystallising certain liabilities, those liabilities should be taken into account in determining the value of the property pool. The value of the particular tax liabilities may be no less certain than the value of the asset to which they relate.

Conclusion

While a period of close to twenty years has passed since the Court first contemplated a departure from the ***Spencer's*** case principle, the value to the owner concept appears to still be undergoing (necessary) refinement. I am of the opinion that the Court has not said all that there is to say on the appropriateness of certain valuation approaches, and trust that the Full Court's rigorous approach to choosing reportable decisions does not see important cases such as ***Wall and Wall*** left out of the public arena, thereby eliminating the opportunity for consideration and debate by interested practitioners.