

## **ADVANCED FAMILY LAW: NAVIGATING COMPLEX ASSET CASES**

- A. Comingled Separate and Community Property**
- B. Vacation Homes or Investment Real Estate Interests**
- C. Family Business Assets**
- D. Interests in Closely Held Corporations**
- E. Stock Option Compensation**
- F. Complex Retirement Plans**
- G. Financial Misconduct**
- H. Spotting Hidden Assets**
- I. Using Forensic Accountants and Business Valuation Experts**
- J. Enforceability of Prenuptial Agreements**

**CAVEAT:** The law of Equitable Distribution does not mean “equal”, it simply means “fair”. What is fair is always subject to a significant amount of interpretation, depending on the nature of the asset, the duration of the marriage, the extent to which either party was involved in obtaining or maintaining the asset, and many other factors. In order to ensure the most accurate and fair property division, it is necessary to employ experts in fields such as accounting, financial analysis, real estate, and property appraisal. When necessary, you will also call upon private investigators who are tasked with uncovering suspected hidden assets.

## A. Comingled Separate and Community Property

Property classification, marital or separate, is significant because *only* marital assets are subject to distribution.

The classification of property is a mixed question of fact and law. The court must evaluate the facts and circumstances surrounding the acquisition of property (e.g., time of acquisition, nature of the transaction, titling, and source of funds) and, given the established facts, determine the proper classification with reference to all relevant rules of law. This task is frequently complicated by arguments of transmutation<sup>1</sup>, which address the *conversion* of separate property into marital property.

- Marital property includes all property accumulated and acquired during the marriage (regardless of how titled) through the joint efforts of the parties; to the extent that a spouse applied marital funds to property, albeit separately titled, the plaintiff is entitled to an equitable distribution of that property or its value, *Massimi v. Massimi*, 35AD 3d 400 (2<sup>nd</sup> Dept. 2006).
- Property acquired during the marriage is presumed to be marital unless it is shown to be separate.
- Separate property includes all property acquired by a spouse before the marriage or via bequest, descent, or gift during the marriage.
- Separate property exchanged for other separate property during the marriage remains separate property.
- Transmutation is the “change in the nature of something; in family law, the transformation of separate property into marital property, or marital property into separate property.”<sup>2</sup>
- The party claiming separate (or dual<sup>5</sup>) property status carries the initial burden of proof.
- Income derived from separate property is considered separate property.
- An increase in the value of separate property attributable to *active appreciation* or other contributions (efforts) of the marital estate is marital, while an increase in value attributable to *passive appreciation* is separate.
- Active appreciation of separate property refers to an increase in value as a result of financial or managerial contributions of one spouse to the separate property during the marriage.

---

<sup>1</sup> Interchangeable with the term “comingling”.

<sup>2</sup> *Black’s Law Dictionary* (2009), 9<sup>th</sup> Edition, pg. 1638.

- Passive appreciation of separate property refers to an increase in value as a result of changing economic conditions and other such circumstances beyond the control of either spouse.
  - A spouse claiming an increase in value of separate property to be marital has the burden of proof, i.e., showing by a preponderance of the evidence that the increase in value is due to active appreciation or other contributions of the marital estate.
  - Assets acquired subsequent to separation are not considered marital property, absent evidence that a spouse used marital property to obtain them.
- 
- a. Bank Accounts, titling most important
    - i. Savings
    - ii. Checking
    - iii. Money Market
    - iv. CD's
  - b. Individual Homes
    - i. Separate Property
    - ii. Separate Account
  - c. Loans
    - i. Mortgages
    - ii. Home Equity
    - iii. Appraisals
  - d. Marital Home
    - i. Spousal Credit
    - ii. Deposits & Down payments
    - iii. Title alternatives
  - e. Automobiles
    - i. Separate account
    - ii. Title alternatives
    - iii. Joint ownership or joint funds
  - f. Other Rights
    - i. Sports Tickets

- ii. Parking Spaces
  - iii. Country Club Memberships
  - iv. Barter Clubs or Affiliations
- g. Equitable Distribution
- i. "A trial court is vested with broad discretion in making an equitable distribution of marital property, and unless it can be shown that the court improvidently exercised that discretion, its determination should not be disturbed" (*Schwartz v Schwartz*. 67 AD3d 989, 990 [internal quotation marks omitted]; *see Scher v Scher*. 91AD3d842, 846-847; *Aloi v Simoni*. 82 AD3d 683, 685). "Moreover, where the determination as to equitable distribution has been made after a nonjury trial, the trial court's assessment of the credibility of witnesses is afforded great weight on appeal" (*Aloi v Simoni*, 82 AD3d at 685; *see Scher v Scher*, 91 AD3d at 847).
  - ii. Gifts from one spouse to the other are marital property subject to equitable distribution (*see Smithie v Smithie*. 122 AD3d 719, 720; *Ferina v Ferina*, 286 AD2d 472, 474; *Chase v Chase*, 208 AD2d 883, 884).
- h. Separate Property
- i. DRL §236(B) (1) (c) says "*the term 'marital property' shall mean all property acquired by either spouse during the marriage.*"
  - ii. At DRL §236 (B) (1) (d) (4), the statute continues by providing: "*Marital property shall not include separate property as hereinafter defined: d. The term 'separate property' shall mean (4) property described as separate property by written agreement of the parties pursuant to subdivision three of this part.*"
  - iii. Although a party is generally entitled to a credit for any contribution of separate property utilized toward the purchase of a marital asset, the partial use of separate funds to acquire a marital asset does not mandate that a credit for separate funds be given (*see Beardslee v Beardslee*. 124 AD3d 969, 969; *Vertucci v Vertucci*. 103 AD3d 999, 1003; *see also Fields v Fields*. 15 NY3d 158, 166-168). Moreover, where separate property has been commingled with marital property, [\*4] there is a presumption that the commingled funds constitute marital property (*see Scher v Scher*, 91 AD3d at 846; *Massimi y Massimi*. 35 AD3d 400, 402).
  - iv. Failure to present sufficient evidence tracing the source of any funds used to purchase the assets at issue to his separate property (*see Robinson v Robinson*, 133 AD3d 1185).

- i. Appreciation not Waived
  - i. An increase in the value of separate property is considered separate property "except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse" (Domestic Relations Law§ 236[B][l][d][3]; *see* Domestic Relations Law§ 236[B][3]). While spouses are free to opt out of that general rule, "the intent to override the rules of equitable distribution whether by express waiver, or by specifically designating as separate property assets that would otherwise be considered marital property under New York law—must be clearly evidenced by the writing" (*Tietjen v Tietjen*. 48 AD3d 789, 791; *see Strong v Dubin*. 75 AD3d 66, 68).
  - ii. In order for a Court to award a party some or another amount of money as representing the equitable share of the increase in the value of the other's separate property attributable to the actions of either spouse, it must first discern what part of the appreciation is "*active*" and what is "*passive*" "*Price v. Price, supra*".
    - 1. Next, the Court must have a reliable source of information in order to award a precise amount or percentage. *Post v. Post*, 68 A.D.3d 741, 890 N.Y.S.2d 581 (2d Dept. 2009).
    - 2. In other words, Courts cannot simply listen to testimony of the parties themselves and thereafter pull figures from thin air. *Iwahara v. Iwahara*, 226 A.D.2d 346, 640 N.Y.S.2d 217 (2d Dept. 1996).
- j. Comingling
  - i. Nevertheless, in order to establish comingling, a party must prove, and the facts must demonstrate that (i) an asset has "*lost its separate property character and identity*" and (ii) the owner expressed, by his or her actions, "*donative intent*." *Schmidlapp v. Schmidlapp*, 220 A.D.2d 571, 632 N.Y.S.2d 593 (2d Dept. 1995).

## B. Vacation Homes and Investment Real Estate

The personal income tax returns of HNWIs are often complex due to the existence of second and third homes, investment properties, and rental properties. A vacation home can be a house, apartment, condominium, mobile home or boat. If they own a vacation home that is rented to others, they generally must report the rental income on their federal income tax return. But they may not have to report that income if the rental period is short.

In most cases, they can deduct expenses of renting their property. The deduction may be limited if they also use the home as a residence.

Here are some tips from the IRS about this type of rental property.

- You usually report rental income and deductible rental expenses on Schedule E, Supplemental Income and Loss.
- You may also be subject to paying Net Investment Income Tax on your rental income.
- If you personally use your property and sometimes rent it to others, special rules apply. You must divide your expenses between the rental use and the personal use. The number of days used for each purpose determines how to divide your costs.
- Report deductible expenses for personal use on Schedule A, Itemized Deductions. These may include costs such as mortgage interest, property taxes and casualty losses.
- If the property is “used as a home,” your rental expense deduction is limited. This means your deduction for rental expenses can’t be more than the rent you received. For more about this rule, see *IRS Publication 527, Residential Rental Property (Including Rental of Vacation Homes)*.
- If the property is “used as a home” and you rent it out fewer than 15 days per year, you do not have to report the rental income.

Report deductible expenses for personal use on Schedule A, Itemized Deductions. These may include costs such as mortgage interest, property taxes and casualty losses. If the property is “used as a home,” your rental expense deduction is limited.

- a. Sole Proprietorships often support
  - i. Second Homes
  - ii. Apartments
- b. Condominiums

- c. Co-Operatives
- d. Time-Shares
- e. Related Parties (i.e., entities)

#### Renting Residential and Vacation Property (Source: IRS)

If you receive rental income for the use of a dwelling unit, such as a house or an apartment, you may deduct certain expenses. These expenses, which may include mortgage interest, real estate taxes, casualty losses, maintenance, utilities, insurance, and depreciation, will reduce the amount of rental income that's subject to tax. You'll generally report such income and expenses on Form 1040 (PDF), *U.S. Individual Income Tax Return*, and on Form 1040, Schedule E (PDF), *Supplemental Income and Loss*. If you're renting to make a profit and don't use the dwelling unit as a residence, then your deductible rental expenses may be more than your gross rental income. Your rental losses, however, generally will be limited by the "at-risk" rules and/or the passive activity loss rules. For information on these limits, refer to Publication 925, *Passive Activities and At-Risk Rules*.

If you rent a dwelling unit to others that you also use as a residence, limitations may apply to the rental expenses you can deduct. You're considered to use a dwelling unit as a residence if you use it for personal purposes during the tax year for more than the greater of:

- 1. 14 days, or
- 2. 10% of the total days you rent it to others at a fair rental price.

It's possible that you'll use more than one dwelling unit as a residence during the year. For example, if you live in your main home for 11 months, your home is a dwelling unit used as a residence. If you live in your vacation home for the other 30 days of the year, your vacation home is also a dwelling unit used as a residence unless you rent your vacation home to others at a fair rental value for 300 or more days during the year.

A day of personal use of a dwelling unit is any day that it's used by:

- You or any other person who has an interest in it, unless you rent your interest to another owner as his or her main home and the other owner pays a fair rental price under a shared equity financing agreement
- A member of your family or of a family of any other person who has an interest in it, unless the family member uses it as his or her main home and pays a fair rental price
- Anyone under an agreement that lets you use some other dwelling unit
- Anyone at less than fair rental price

If you use the dwelling unit for both rental and personal purposes, you generally must divide your total expenses between the rental use and the personal use based on the number of days used for each purpose. You won't be able to deduct your rental expense in excess of the gross rental income limitation (your gross rental income less the rental portion of mortgage interest, real estate taxes,

and casualty losses, and rental expenses like realtors' fees and advertising costs). However, you may be able to carry forward some of these rental expenses to the next year, subject to the gross rental income limitation for that year. If you itemize your deductions on Form 1040, Schedule A (PDF), *Itemized Deductions*, you may still be able to deduct your personal portion of mortgage interest, property taxes, and casualty losses on that schedule.

There's a special rule if you use a dwelling unit as a residence and rent it for fewer than 15 days. In this case, don't report any of the rental income and don't deduct any expenses as rental expenses.

Another special rule applies if you rent part of your home to your employer and provide services for your employer in that rented space. In this case, report the rental income. You can deduct mortgage interest, qualified mortgage insurance premiums, real estate taxes, and personal casualty losses for the rented part, subject to any limitations, but don't deduct any business expenses. For information on these limits, refer to Publication 587, *Business Use of Your Home (Including Use by Daycare Providers)*.

If you have a rental income, you may be subject to the Net Investment Income Tax (NIIT). For more information, refer to *IRS Topic 559*.

## C. Family Business Assets

- a. Shareholder Status
  - i. Class Standing
    - 1. Common
    - 2. Preferred
  - ii. Voting vs. Non-Voting
- b. Perquisites
  - i. Company Automobiles
  - ii. Boats & Yacht Clubs
  - iii. Country Club Memberships (Golf, Tennis, Skiing, etc.)
  - iv. Private Jets
- c. Family Office
- d. Farmland or Private Preserves
  - i. Wineries
  - ii. Cannabis Sanctuary (new)

## **D. Interests in Closely Held Corporations**

- a. Types
  - i. C-corporations
  - ii. S-corporations
  - iii. Limited Liability Companies
  - iv. General Partnerships
  - v. Limited Partnerships
- b. Minority Interests
  - i. Voting
  - ii. Non-Voting
  - iii. Preferred Shareholding
- c. Phantom Stock
- d. Stock Awards
- e. Retirement Bonuses
- f. Earn-Outs
- g. Key-Person Compensation
- h. Shareholder Loans

## E. Stock Option Compensation

Are the stock options in the divorce you're handling being valued at their full and fair economic value?

In many divorces today, stock options account for a significant portion of the marital wealth to be divided. For anyone not familiar with option-valuation methodologies, the fair economic value of options can be difficult to understand. Consequently, attorneys who represent employee spouses all too often get away with valuing options at their so-called "intrinsic value." An option's "intrinsic value" is almost always less than its fair economic value. It is often zero.

The valuation models coming into play under the accounting rules<sup>3</sup> are almost as unfair to non-employee spouses as is "intrinsic-value" methodology. The accounting rules prescribe how corporations should account for employee stock options in their financial reports. People refer to the models being used under accounting rules as "option-valuation models." But that's not what they are. They are models for estimating the expense that a corporation is likely to incur from issuing options. Most of the models assume that an employee will exercise the options "suboptimally." In other words the models assume the employee will engage in a bad bargain. A model that posits and factors in bad bargains does not produce fair economic values.

When stock options are undervalued in a divorce, the non-employee spouse does not receive her or his fair share of that portion of the marital wealth.

- a. Stock Option Types
  - i. Calls (ESOs)
  - ii. ISOs
  - iii. Puts (also ISO)
- b. Warrants
  - i. Usually issued with loans (i.e, debt)
  - ii. Maybe preferential
  - iii. May never be called
- c. Other Derivative Instruments
  - i. Profits Interest

---

<sup>3</sup> Aka FASB or SEC guidelines

- ii. Stock Appreciation Rights (SARs)
  - iii. Phantom Stock
  - iv. Restricted Stock Units (RSUs)"
- d. Valuation

### **European Stock Options**

A European stock option has a share of stock as an underlying good. An option that is European in form can be exercised only at its expiration. The Black-Scholes Model prices European option as a function of five variables: the stock price, the exercise price, the annualized standard deviation of stock returns, the risk-free rate, and the time until expiration. The Black-Scholes Model was extended by Robert Merton to reflect a continuous dividend rate paid by the stock.

For this model, specify the stock price, the exercise price, the number of days until expiration, the standard deviation per year, and the annualized risk-free rate. The annualized dividend rate may be left as zero, or it may be specified. Based on these inputs, we can compute the call and put prices and the sensitivities of each price to the underlying inputs. Once a valid solution is achieved, it can be graphically depicted.

### **Economic Background**

Fischer Black and Myron Scholes developed their option pricing model under the assumptions that asset prices adjust to prevent arbitrage, that stock prices change continuously, and that stock returns follow a log-normal distribution. Also, their model holds for European call options on stocks with no dividends. Further, they assume that the interest rate and the volatility of the stock remain constant over the life of the option. The form of the Black-Scholes model parallels the bounds on option pricing, and the Black-Scholes model is very close to the *binomial* model.

Robert Merton has shown how to adjust the Black-Scholes model to account for dividends when the dividend is paid at a continuous rate. Instead of focusing on the quarterly dividends that characterize individual stocks, Merton's model applies when the dividend is paid continuously. Essentially, the adjustment for continuous dividends treats the dividend rate as a negative interest rate. Dividends reduce the value of a call option, because they reduce the value of the stock that underlies the option. In effect, we have a continuous leakage of value from the stock that equals the dividend rate. We let the Greek letter delta represent this rate of leakage.

The Black Scholes Model is one of the most important concepts in modern financial theory. It was developed in 1973 by Fisher Black, Robert Merton and Myron Scholes and is still widely used today, and regarded as one of the best ways of determining fair prices of options.

A model of price variation over time of financial instruments such as stocks that can, among other things, be used to determine the price of a European call option. The model assumes that the price of heavily traded assets follow a geometric Brownian motion with constant drift and volatility. When applied to a stock option, the model incorporates the constant price variation of the stock, the time value of money, the option's strike price and the time to the option's expiry.

Below is the world famous Black-Scholes formula -- perhaps the most frequently used formula with embedded probabilities in human history. The value of a call is seen to depend on six variables: the current underlying asset price ( $S$ ), the option strike price ( $K$ ), the option time-to-expiration ( $t$ ), the riskless return ( $r$ ), the underlying asset payout return ( $d$ ), and the underlying asset volatility ( $s$ ).

- $x$  is not a new variable but is defined in terms of the six original variables.  $N(\cdot)$  is the area under a standard normal distribution function. As such, it is a number between 0 and 1. So we see that the formula takes the form of the difference between two terms:  $Sd-t$  (the present value of the underlying asset price at expiration) and  $Kr-t$  (the present value of the strike price to be paid at expiration), with each weighted by a number between 0 and 1.

To summarize our earlier discussion, in the multi-period binomial option pricing formula, we let  $r$ ,  $d$ ,  $u$  and  $d$  depend on  $n$  as follows:

- $r = rt/n$      $d = dt/n$      $u = es^{\sigma t}/n$      $d = 1/u$
- Then, holding  $t$  fixed, we ask what happens as  $n$  goes to infinity. Recall the multi-period binomial option pricing formula is:
- $C = Sd-nF[a; n, p'] - Kr-nF[a; n, p]$  with  $p \approx ((r/d) - d)/(u - d)$  and  $p' \approx (u/(r/d))p$

Using the above definitions, we can substitute to obtain:

- $C = Sd-tF[a; n, p'] - Kr-tF[a; n, p]$

And as  $n$  goes to infinity, it can be shown formally that:

- $F[a; n, p'] \approx N(x)$  and  $F[a; n, p] \approx N(x - s\sigma t)$  with  $x \approx [\log(Sd-t/Kr-t), s\sigma t] + \frac{1}{2}s\sigma t$

The key assumptions of the Black-Scholes model are:

- The price of the underlying instrument  $S_t$  follows a geometric Brownian motion with constant drift  $\mu$  and volatility  $\sigma$ :

$$dS_t = \mu S_t dt + \sigma S_t dW_t$$

- It is possible to short sell the underlying stock.
- There are no arbitrage opportunities.
- Trading in the stock is continuous.

- There are no transaction costs or taxes.
- All securities are perfectly divisible (*e.g.* it is possible to buy 1/100th of a share).
- It is possible to borrow and lend cash at a constant risk-free interest rate.

### **Binomial Model with Specified Price Movements**

We can also compute call and put option prices for European options based on specified price movements. The model requires data inputs for the stock price, the exercise price, and the number of periods until expiration. The binomial model allows the stock price to rise by a given amount each period or to fall by a given amount each period. These must be specified in percentage terms. In addition, specify the risk-free rate per period. The up movement must exceed the risk-free rate as an economic condition.

Based on these input values, we can compute call and put prices, the maximum, minimum, and expected stock price at expiration and the chance of a stock price increase in each period.

#### **Economic Background**

The Single-Period Binomial Call Pricing Model holds for a call option expiring in one period when the stock price will rise by a known percentage or fall by a known percentage. The model shows that the value of a call option equals a long position in the stock, plus some borrowing at the risk-free rate. The multi-period binomial model can reflect numerous stock price outcomes, if there are numerous periods. Just 20 periods gives more than 1 million stock price movement patterns.

The binomial model requires that the price move up a given percentage or down a given percentage. Therefore, if we shorten the period, we need to adjust the stock price movements to correspond to the shorter period. While up or down 10 percent might be reasonable for a period of one year, it certainly would not be reasonable for a period of one day. Similarly, a risk-free rate of 6 percent makes sense for a period of one year, but not for a period of one day.

By adjusting the period length, the stock price movement, and the interest rate, we can refine the binomial model as much as we wish. For example, we could assume that the stock price could move one-hundredth of a percent every minute of the year if we wished. Under this assumption, the model would have finer partitions than exist in the market for most stock. However, with the price changing every minute and a time to expiration of one year, we would have trillions of possible stock price outcomes to consider. While having so many periods would be computationally expensive, we could apply the model if we wished. Conceptually, we could make each period so short that the stock price would change continuously.

In discussing the binomial model, we have not used the concept of probability. For example, we have not considered the likelihood that the stock price will rise or fall. While we have not explicitly used probabilistic concepts, the array of prices does imply a certain probability that the stock price will rise, if we are willing to assume that investors are risk neutral. The option prices that we compute under the assumption of risk neutrality are the

same as those we found from strict no-arbitrage conditions without any reference to probabilities.

### **American Stock Options**

American options are just like European options, except the American option allows the privilege of early exercise. Because of this parallel between the two kinds of options, we analyze American options by contrasting them with the simpler European options that we have already considered, under the assumption that the options are parallel—have the same underlying good, the same exercise price, and the same time until expiration.

The difference in price between parallel American and European options must stem from the early exercise feature of the American option. Thus, if we know the price of a European option, we can price the parallel American option by determining the impact of the early exercise privilege. The value of the right to exercise before expiration is the early exercise premium. Much of American option pricing turns on valuing the early exercise premium.

### **Economic Background**

In general, there is no closed-form solution to the value of an American call option on a dividend paying stock. However, an exact pricing formula is possible in one special case. It is possible to compute the exact price for an option on a stock that pays a single dividend during the life of the option. The model is also known as the *Compound Option Model*.

An American call option really consists of a series of options that expire just before the various dividend dates and at the actual expiration of the option. The exact pricing model applies to the situation when there is just one dividend between the present and the expiration date of the option.

If exercise is to occur, it should occur just before the ex-dividend date, to capture the value of the dividend. If the call is not exercised, the instant after the dividend payment occurs, the call is effectively a European call, because there are no more dividend payments, and early exercise on a European call is never rational.

Considering the American call before the dividend date, we can see that it is really a compound option, or an option on an option. It is an option on an option because the owner has the option to refrain from exercising and to own a European option.

### **Other Types**

In recent years, financial engineers have created a variety of complex options that are collectively known as exotic options. The payoffs on these options are considerably more diverse than the payoffs on the straightforward options that we have considered to this point. For example, the payoff on a *lookback call option* depends on the minimum stock price experienced during some past period. Other exotic options have different and more complicated payoff structures..

We approach these exotic options by contrasting them with the plain vanilla options explored earlier. For a plain vanilla option, the value of an option at any particular moment depends only upon the current price of the underlying good, the exercise price, the risk-free rate of interest, the volatility of the underlying good, the time until expiration, and the dividend rate on the underlying good. Further, there is a fixed underlying good, a fixed and stated exercise price, a known time to expiration, and no special conditions on any of the option parameters.

With respect to the price of the underlying good, it is important to emphasize that the price of a plain vanilla option depends only on the current price of the underlying good, so the price of the option is independent of the price path followed by the underlying good. Many exotic options exhibit path dependence--the price of the option today depends on the previous or future price path followed by the underlying good. For example, the price of a lookback call option depends on the minimum price reached by the underlying good over some past period. Further, the price of an *average price option* depends upon the future average price of the underlying good. Thus, to price a path-dependent option, it is not enough to know the current price of the underlying good. Instead, we must have information about the previous path that the price of the underlying good traversed.

There are at least nine classes of exotic options:

Forward Start Options

Compound Options

Standard Chooser Option

Barrier Options

Binary Options

Lookback Options

Average Price Options

Exchange Options

Rainbow Options

Because of the complexity of these options, we focus on European options, emphasizing cases in which closed-form solutions are available. For most American exotic options, and for some European exotic options, there is no exact pricing formula. For these options, *simulation or approximation methods* must be used to estimate the price.

## F. Complex Retirement Plans

- a. LTIs – Long-term Incentive(s) – Stock Options (see Topic E.)
- b. IRAs and SEPs
- c. 401(k)s and Self-Employed 401(k)s
- d. Annuities and Life Insurance
- e. Earnouts – compensation in excess of the purchase price, a bonus
- f. Severance Packages – separation and/or termination
- g. Performance-Based Pensions
- h. Top Hat Plans (Deferred Bonus Plans)
- i. Excess Benefit Plans
- j. SERPs – Supplemental (Senior) Executive Retirement Plans (HNWI), rare
- k. Use of QDROs

In a divorce, if there are children involved, then decisions regarding child custody and child support payments need to be addressed. There may also be a conflict over which spouse will receive certain properties. That is why retirement plans and pensions are sometimes overlooked during this confusion.

The QDRO allows the court to order that a spouse, an ex-spouse, a child or some other person can collect money from an individual's retirement plan or pension. This process is considered by the court just as any other component of the division of marital assets.

A QDRO is an effective way to ensure that you and/ or your child's future financial needs are protected. For example, if you should somehow become declared legally incompetent, the QDRO can even allow the payment from the payee's retirement or pension plan to be made available to a minor child's guardian or someone acting as your trustee or agent.

## **G. Spotting Hidden Assets**

- a. Lifestyle Analysis
  - i. Checkbook versus Income
  - ii. Cash Spending (Unreported Income)
  - iii. Explicit Spending
  - iv. Implied Spending
- b. Business Credit Cards
  - i. Company Credit Card
  - ii. Affinity Cards
    - 1. Gambling
    - 2. Vacation Spots
- c. Personal Use of Business Assets
  - i. Company Car
  - ii. Boats & Yachts
  - iii. Private Jets
  - iv. Memberships
- d. Use of Private Investigation Firms and Corporate Consultants
  - i. Background checks on associates
  - ii. Dummy corporations and straw entities

## **H. Financial Misconduct**

- a. Non-Disclosure on Statement of Net Worth
  - i. Dummy corporations
  - ii. Shell companies
  - iii. Strawman
- b. Fraudulent Transfers & Conveyances
  - i. Life Estate or Remainder Interest
  - ii. Bargain sale and/or deed
- c. Insurance Fraud
  - i. Stolen vehicles
  - ii. Staged burglaries
- d. Fraudulent Financial Reporting
- e. Fraudulent Income Tax Reporting
- f. Embezzlement
- g. Obtaining Innocent Spouse Status
- h. Involving the Authorities (i.e., the FBI)

## I. Enforceability of Prenuptial Agreements

- a. Domestic Relations Law§ 236(B)(3) provides that "[a]n agreement by the parties, made before or during the marriage, shall be valid and enforceable in a matrimonial action if such agreement is in writing, subscribed by the parties, and acknowledged or proven in the manner required to entitle a deed to be recorded."
- b. It is a settled proposition that separate property remains separate "*unless the actions of the titled spouse demonstrate his or her intent to transform the character of the property from separate to marital*". *Sherman v. Sherman*, 304 A.D.2d 744, 758 N.Y.S.2d 667 (2d Dept. 2003); *Rachimi v. Rachimi*, 57 A.D.3d 277, 869 N.Y.S.2d 414 (1st Dept. 2008). Moreover, transmutation is found only when property is comingled to the extent that it loses its "*separate property identity and character*." *Sherman v. Sherman, supra*.
- c. Without getting unnecessarily prolix regarding the law surrounding the Court's role in interpreting and enforcing agreements, marital or otherwise, suffice it to say for now, clear and unambiguous contracts should be enforced according to their terms and plain meaning. (*Signature Realty v. Tallman*, 2 N.Y.3d 810, 811, 781N.Y.S.2d259, 260 [Ct. App. 2004]; *Greenfield v. Philles Records*, 98 N.Y.2d 562, 569-570, 750 N.Y.S.2d 565, 570 [Ct. App. 2002]; *Fiore v. Fiore*, 46 N.Y.2d 971, 973, 415 N.Y.S.2d 836 [Ct. App. 1979].
  - i. Moreover, it is a well settled and eminently sensible proposition that Courts are to enforce contracts so they are given life, not to obtain an absurd result (*Hooper Associates v. AGS Computers*, 74 N.Y.2d 487, 491, 549 N.Y.S.2d 365, 367 [Ct. App. 1989]; *Williams Press v. State*, 37 N.Y.2d 434, 440, 393 N.Y.S.2d 72, 77 [Ct. App. 1975]; *Tri-Messine Inst. v. Telesector Res. Group, Inc.*, 287 A.D.2d 558, 731 N.Y.S.2d 648 [2d Dept. 2001]).
  - ii. Marital agreements are subject to the same rules of construction and enforcement as other contracts negotiated at arm's length. (*Girardin v. Girardin*, 281A.D.2d457, 721N.Y.S.2d672 [2d Dept. 2001]; *Titum v. Fuks*, 221A.D.2d642, 634 N.Y.S.2d 508 [2d Dept. 1995]).
- d. It is equally settled that, in the absence of some patent defect or illegality, Courts should refrain from granting any relief inconsistent with the clear provisions of an otherwise valid and enforceable agreement...even in matrimonial actions. *Fishier v. Fishier*. 2 A.D.3d 487, 769 N.Y.S.2d 273 (2d Dept. 2003).
- e. Exceptions to Domestic Relations Law (DRL) Section 236(B)
  - i. Notwithstanding, to the extent that the appreciation of a separate asset is at all "aided or facilitated" by the non-titled spouse's direct or indirect efforts, that appreciation is marital and subject to equitable

distribution, *Hartog v. Hartog*, 85 NY2d 36 (1995).

ii. Independently, and together, these provisions constitute an effective and unassailable waiver of any prospective property rights either party may have gained by their marriage and DRL §236(8). (*Nassau Trust Co. v. Montrose Concrete Prods. Corp.*, 56 NY 2d 175, 451 NYS 2d 663[Ct. App. 1982] generally; defining when a waiver is effective). *Teiftjen v. Teiftjen*, 48 A.D.3d 789, 853 N.Y.S.2d 118 (2d Dept 2011). In other words, in this case, and following the prevailing Appellate authority, unless the property being considered has lost its "*separate property character*" as the term "*separate property*" is defined by the agreement itself: its status is protected.

iii. Importantly, any desire on the Court's part to deviate from the explicit language employed by the parties in order to introduce DRL §236(B)'s equitable distribution apparatus must be avoided and the contract enforced in accordance with the "*manifest intent*" of the parties at the time of making. *Vermont Teddy Bear v. 538 Maddison Realty*, 1 N.Y.3d 470, 475, 775 N.Y.S.2d 765, 767 (Ct. App. 2004); *Nichols v. Nichols*, 306 N.Y. 490, 119 NE 2d 351 (Ct. App. 1954).

a. Unconscionability

iv. Such an agreement may include, *inter alia*, a "provision for the amount and duration of maintenance or other terms and conditions of the marriage relationship ... provided that such terms were fair and reasonable at the time of the making of the agreement and are not unconscionable at the time of entry of final judgment" (Domestic Relations Law§ 236[B][3]).

v. "An unconscionable bargain is one which no person in his or her senses and not under delusion would make on the one hand, and no honest and fair person would accept on the other, the inequality being so strong and manifest as to shock the conscience and confound the judgment of any person of common sense" (*Morad y Morad*, 27 AD3d 626, 627; *see Christian v Christian*, 42 NY2d 63, 71; *Label y Label*, 70 AD3d 898, 899).

b. Post-Nuptial Agreements

vi. Unconscionability (same as above)

vii. Require consideration, *Whitmore v. Whitmore*, 8 A.D. 3<sup>rd</sup> 371 (2<sup>nd</sup> Dept. 2004)

- c. Amendments (may or may not also require new consideration)
- d. Seeking to set aside these contracts

viii. Motion practice

ix. Intervenor or Inquest

x. CAMP

xi. Trial or Hearing

## **J. Using Forensic Accountants and Business Valuation Experts**

### **a. Net Worth Statement Preparation and Analysis**

- i. Sources of Information
  - 1. Bank Statements
  - 2. Income Tax Returns
  - 3. Credit Card Statements
- ii. Other Assets & Liabilities
  - 1. Personal Financial Statements - HNWI
  - 2. Credit Reports
  - 3. Property Records

### **b. Review of Private Business Owner Documentation (accessible)**

- 1. Financial Statements
  - a. Audited
  - b. Reviewed
  - c. Compiled
  - d. Supplemental Financial Information
  - e. General Ledgers
  - f. Bank Statements & Reconciliations
- 2. Income Tax Returns
  - a. 1120
  - b. 1120S
  - c. 1065
  - d. State Filings
  - e. Sales Tax Filings and/or Audits
  - f. Franchise Tax Filings
  - g. Gift Tax Returns
  - h. Estate Tax Returns
- 3. Bank Loans and/or Financing
  - a. Note Documentation
  - b. Lines of Credit
  - c. Borrowing Base Documents

- d. Personal Guarantees
  - e. Personal Financial Statements
4. Significant Contracts
- a. Customers
  - b. Purchase Orders
  - c. Formal Contracts
  - d. Sole-Supply
  - e. Servicing (Periodic)
  - f. Vendor Commitments
  - g. Leases
  - h. Premises (Lessee)
  - i. Equipment & Equipment
  - j. Capital Leases
  - k. Employees
  - l. Non-Compete
  - m. Management
  - n. Consulting
5. Legal Documents
- a. Certificate of Incorporation
  - b. Stock Ledger
  - c. By-Laws
  - d. Shareholders' or Operating Agreements
  - e. Buy-Sell Agreements & Certificates of Value
  - f. Transfer and Assumption Documents (Minority Holders)
  - g. Insurance Policies

**c. Expert Reports**

A comprehensive (written) business appraisal report should contain the following:

- An introduction, including the purpose and use, the standard of value, description of what is being appraised, and limiting conditions.
- An economic analysis and industry section (i.e., RR 59-60, Factor #2)
  - Current Economic Reports
    - National
    - Regional
    - State
    - Local (County)
  - Industry Research
    - National
    - Regional
    - Recent Market Transactions (i.e., RR 59-60, Factor #8)
    - Financial Trends and Ratios
- An analysis and description of the subject business including its history and future prospects.
- A financial analysis of the subject company.
- A financial forecast including assumptions used.
- A discussion of the valuation process and methods used including a detailed explanation of how each method utilized was applied.
- A description of any applicable discounts or premiums applied including justification for amounts selected.
- A reconciliation of indicated values developed from the various business appraisal methods utilized.
- The professional qualifications of the appraiser showing that the appraiser has the qualifications and experience necessary to perform business appraisals.
- Exhibits showing historical financial information, projections, and other information used in preparing the business appraisal.

**d. Using Experts**

This depends wholly on your client's situation, the complexity of assets, and the budget appetite to employ these expensive services. Ultimately, an expert report will be the end-product in a variety of situations:

**FORENSIC ACCOUNTANTS**

Ph.D's, usually economists can opine on complex assets

CPA/ABV and CPA/CFF

Certified Fraud Examiners

DABFAs

**SELECTING A BUSINESS APPRAISER**

Most professionals, such as doctors, attorneys, engineers, dentists, etc. have clearly defined career paths that must be followed to enter their profession. Typically, a specific college program must be completed followed by some examination for licensing or other certification.

Unfortunately, the business valuation profession does not have a clearly defined path. No specific college major exists for business valuation, nor are there any governmental licensing requirements to prove minimum competency. Because of this lack of a specific career path and licensing requirements, many individuals with different backgrounds claim expertise and perform business appraisals often with poor results.

Business appraisers typically come from one of the following groups: certified public accountants (CPAs), business brokers, college professors, and stockbrokers. Without special training and business valuation credentials, none of the individuals from these groups are competent to do business appraisals. Very few individuals actually performing business appraisals have earned a professional designation from a recognized professional organization certifying business appraisers.

For years many assumed CPAs were competent in valuing businesses. In 1997 the American Institute of Certified Public Accountants (AICPA) established a special credential for business valuation called Accredited in Business Valuation (ABV) to demonstrate competence in business appraisal. This seems to indicate that the vast majority of CPAs nationwide have little or no training or expertise in business valuation. Another problem for CPA's is potential conflicts of interest. In 1991, another organization called the National Association of Certified Valuation Analysts (NACVA), exclusively for CPAs, was also

formed to give CPAs some training and a credential in business valuation called Certified Valuation Analyst (CVA). However, only approximately "one percent" of the CPA's across the nation currently hold either of these two credentials in business valuation.

Business brokers sell businesses, but most have no training in business valuation. Often business brokers use generic rules of thumb to list and sell businesses. Also, many business brokers lack the financial expertise necessary to properly analyze a company's financial statements.

College professors typically have expertise in financial theory and may be able to analyze financial statements, but they often try to apply sophisticated financial techniques designed for very large companies to small privately held companies. They also often lack the "real world" experience necessary to properly value most privately held companies.

Stockbrokers and stock analysts usually have the ability to analyze financial statements and understand public markets. However, they typically have no experience dealing with privately held companies.

In order to meet the need of demonstrating competence in business valuation, several professional organizations have evolved that certify business appraisers. Additionally, often a business appraisal is done because of some type of litigation. Historically, it was fairly easy to qualify an individual with a business background as an "expert witness." In 1993, this began to change. Now, trial judges are deemed to be "gatekeepers." Meaning that the trial judge has the ability to exclude experts if they do not meet appropriate standards. It is now more important than ever to ensure that an expert witness has the credentials and experience to survive a challenge. Otherwise, their testimony might be excluded in court, or perhaps, admitted but given little or no weight.

The four organizations in the United States that certify business appraisers are: 1) The Institute of Business Appraisers, Inc.; 2) the American Society of Appraisers; 3) the National Association of Certified Valuation Analysts; and 4) the American Institute of Certified Public Accountants. The table shown below compares and contrasts the requirements to obtain credentials from each of these professional organizations. Before you select a business appraiser, carefully review his or her credentials and experience. Generally, those who have obtained the more difficult credentials, such as the Certified Business Appraiser (CBA) from the Institute of Business Appraisers or the Accredited Senior Appraiser (ASA) in business valuation from the American Society of Appraisers, will do high quality work and be well regarded in court.

Business Valuation Credentials				
A Comparison of the Primary Requirements to Obtain & Maintain a Credential				
Requirement	CBA <sup>1</sup>	ASA/AM <sup>2</sup>	CVA <sup>3</sup>	ABV <sup>4</sup>
Education	College/Equivalent	College/Equivalent	College/Equivalent	College/Equivalent
Experience	Minimum of two assignments--two reports must be submitted and approved	5 Years for ASA; 2 years for AM	No Minimum	Involved in 10 Business Valuations
Qualifying Exam	Proctored, Closed Book	Proctored, Closed Book. Also must pass an Ethics Exam. A USPAP exam must be passed every five years	Take-Home, Open Book until 1999; Proctored, Closed Book starting in 1999. Exam includes a report writing portion.	Proctored, Closed Book
Report Review Requirement	Yes, 2 Reports rigorously reviewed by leading Business Appraisers	Yes, 2 Reports rigorously reviewed by leading Business Appraisers	None other than portion of qualifying exam.	None
Continuing Professional Education	Yes, 24 Credits every two years or equivalent	Yes, 100 Credits every five years	Must maintain CPA credential. Other classes in business valuation are required to maintain designation.	60 Credits and involvement in 5 reports every 3 years
Organization has Professional Standards	Yes, for over ten years	Yes, for over ten years	Yes, since 1995	Yes, since 2008
Organizations Awarding the Above Referenced Business Valuation Professional Designations				
(1) CBA	Certified Business Appraiser from The Institute of Business Appraisers, Inc.			
(2) ASA/AM	Accredited Senior Appraiser/Accredited Member from the American Society of Appraisers			
(3) CVA	Certified Valuation Analyst from the National Association of Certified Valuation Analysts			
(4) ABV	Accredited in Business Valuation awarded to CPAs by the American Institute of Certified Public Accountants			

**Contact Information:**

**Paul G. Marquez, JD CPA/ABV/CFF ASA**  
*Certified Business Appraiser*

**SIGMA VALUATION CONSULTING, INC.**  
**355 Lexington Avenue, Suite 401**  
**New York, NY 10017**  
**Direct: 917-450-0828**  
**Long Island: 631-754-3779**  
**eFax: 646-219-7120**  
**[pmarquez@sigmavaluation.com](mailto:pmarquez@sigmavaluation.com)**  
**[www.NationalBizVal.com](http://www.NationalBizVal.com)**