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Newsletter of Ron J. Anfuso, CPA/ABV, An Accountancy Corp.

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Ron's Corner

Because each case is unique, the courts have not established precise criteria concerning apportionment between separate and community property business interests. Courts may use either of two approaches, or a "hybrid"approach, when determining the community's interest.[1]

The ***Pereira*** method is the preferred choice when attributing business profits mainly to the efforts, skill or time of a spouse during the marriage. Accountants use Pereira to allocate a fair return to the separate property investment and to apportion the remainder of the increased value to community property that materialized from community efforts.

Accountants, however, use the ***Van Camp*** method when the increase in the value of a spouse's separate property is essentially the result of market forces or the uniqueness of the business and not as much on the efforts of the spouse.

In some instances, however, a case cannot achieve an equitable apportionment via Pereira or Van Camp alone. Then it is up to the trial court to decide whether a hybrid formula, such as the ***Capital Labor Apportionment Model***, would be the most substantially just method to apply.

In this issue of ***Forensic Accounting Today***, I will explore the trial court cases and appeal of ***In re Marriage of Brandes***. In this matter, the trial court approved applying a hybrid approach, which then was upheld by the Appeals Court. I hope you will find this presentation helpful.

Ron

1. Although it is referred to as a hybrid, it is actually a two-step calculation

The Use of a "*Hybrid*"[1] Formula in Apportionment: In re Marriage of Brandes

Presented by Ron J. Anfuso, CPA, ABV, CFF, CDFA, FABFA

Background

Charles Brandes founded BIP in 1974 to provide investment advisory services for fees based on the percentage of the company's clients' assets under management. When Charles and Linda met in 1983, BIP managed assets of $8.2 million. His annual income was $44,148.

Linda agreed to marry Charles after he showed the initiative to make enough money to support their families. Each had two children from previous marriages. They married in 1986.

The year before they wed, Charles sold 10 percent of his business to a long-term client. Thereafter, the business grew exponentially, increasing its managed assets by eight times by the end of 1986. When the parties separated in 2004, Charles had already repurchased the 10 percent he had sold, and the value of the community had soared to $208 million, excluding any interest in BIP.

The managed assets of the firm grew to $213 million by the end of 1991 as a result of Charles's efforts. By that time, he had appointed a CEO and COO to run the firm. The chief executive urged Charles to focus on institutional markets and hire a marketing specialist who had a superior track record.

At the beginning of 1992, BIP established an executive committee to take over the firm's administrative decisions. Although BIP grew to $85 billion in managed assets by 2004, success was mostly attributed to outside factors, such as bull markets and a growing foreign investor market.

The Trials

In 2005, the trial court entered into a judgment of dissolution concerning marital status. Two separate trials, referred to as *Phase I* and *Phase II*, were held to address unresolved financial issues.

The trial of Phase I took place in 2008. The relevant issue was how

Continued on page 2

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Hybrid Formulas in Apportionment: Continued from page 1

to characterize BIP. Linda argued that BIP became an entirely new business and should fall under community property. She contended that the court should apply the ***Pereira Formula*** between the date of their marriage and 1995. By 1995, Charles's efforts no longer were causing the growth of BIP. Thus, Charles claimed that BIP was his separate property and that the ***Van Camp Formula*** should be applied because the firm's growth could be attributed mainly to factors other than his personal efforts. The trial court concluded that the community had acquired an interest in BIP during the Pereira period, but that the community had been overcompensated for Charles's services throughout the Van Camp period. Thus, the community was not entitled to additional funds. Charles and Linda then stipulated that the community interest of the increased value of BIP during the Peirera period amounted to $3,600,932.

The trial court began holding Phase II in March 2011. Among the concerns addressed were the valuation method for BIP and Linda's contention that the community was entitled to an equitable allocation of BIP's value under a *hybrid Pereira/Van Camp formula*. The trial court's statement reaffirmed that the community was not entitled to an additional payment under Van Camp. However, the court awarded Linda $450,000 per month for spousal support. Moreover, the court decided to value BIP by investment rather than fair-market value. The stipulated worth of Charles's interest in BIP was $372,982,000. In addition to support, the court ordered Charles to make an equalizing payment to Linda of $10,052,042 as of the result of a ***Disso*** judgment.

The Appeal

The Panel asserted that when the personal efforts of a spouse increase the value of that spouse's separate business property, the court must determine the contributions of the separate capital and the community effort. Furthermore, the Panel concurred that in a Pereira allocation, there is no need for the court to limit the community interest to the salary of a spouse. When the spouse's effort is minimally involved in the business and the business profits are attributed to the character of the business, according to the Panel, the choice should be Van Camp.

Linda's only challenge to the findings was the court's application of law. She believed the community had a 100 percent ownership interest in BIP. Citing the case of *Mueller v. Mueller (1956) 144 Cal. App.2d 245*, Linda argued that the evidence analysis affirmed the court's findings that the business was community property. The panel's position, however, was that Mueller did not suggest that the growth of a business during a marriage causes a business to lose its separate property character. As a result, the Appeals Court agreed with the findings of the trial court with the exception of the characterization of the shares of stock Charles reacquired from his sale of 10 percent of the ownership in BIP in 1985.

In the next issue, I will cover the application of the hybrid ***Capital Labor Apportionment Model*** (CLAM).

* For an explanation of these titles, please visit our website or request a copy of Issue 3 of ***Forensic Accounting Today.***