

Keane: “Double Dipping”, Tangible versus Intangible Assets¹

Elliott Scheinberg, Esq. and Ronald J. Klein, CPA

In *Keane v. Keane*,² the Court of Appeals, via its adoption of the dissenting opinion in the Appellate Division decision, recently explicated and amplified the principle of “double dipping.” Specifically, the court echoed the prohibition against twice counting the income associated with an intangible asset, such as, a professional license, when making distributive and maintenance awards but declined to extend the principle to the distribution of a tangible income-producing asset and the subsequent award of maintenance from income derived from that asset. This article sets forth the governing law and offers illustrative examples for instructional purposes only as to the implications of the decision.

Double Dipping

What is double dipping? Double dipping occurs when a court converts a certain amount of the titled spouse’s projected future income stream into an asset by fixing the present value of a business or license, and then makes an award of maintenance based on the titled spouse’s *total* income, which includes the excess earnings produced by the business or license. The income used in determining the present value of a business or license must be deducted from the calculation of future enhanced earning capacity so that when there is a maintenance award the court must reduce the value of the enhanced earnings by the amount awarded in maintenance.³ In essence, the converted income, once distributed as an asset, may no longer be calculated into the maintenance formula.

Grunfeld v. Grunfeld,⁴ wherein the First Department addressed the distribution of a law practice, discerned the nuances between “double counting” from “double dipping”: “... ‘double counting’ frequently refers to the use of the same stream of income to calculate the value of more than one asset,” such as when the same income stream is used to value a professional practice and the enhanced earning capacity arising from the license which authorizes the professional to operate the practice, or to value a practice, license, or business, and thereafter compute spousal maintenance from it. “The slightly different term ‘double dipping’”, *Grunfeld* continued, “sometimes [] refers to the court ordered payment of more than one financial obligation from the same source” – both issues can exist in one case “as [in *Grunfeld*] where a spouse is a long-time partner in a law practice” calling into play the valuation of goodwill via the excess earnings

¹ N.Y.L.J., May 24, 2007.

² *Keane v. Keane*, 8 N.Y.3d 115 (2006).

³ *Wadsworth v. Wadsworth*, 219 A.D.2d 410 (4th Dept. 1996); see, *Grunfeld v. Grunfeld*, 94 N.Y.2d 696 (2000).

⁴ *Grunfeld v. Grunfeld*, 255 A.D.2d 12 (1st Dept.,1999).

method.

Grunfeld explained: to evaluate goodwill, “we subtract from the spouse's actual earnings (using a weighted average of past annual earnings) the ‘reasonable compensation’ for a similar attorney, and then multiply the difference, i.e., the ‘excess earnings,’ by a factor ... [that] is called the capitalization rate ... [to] calculate the present value of the expected future stream of income.”⁵

Grunfeld went on to demonstrate how double dipping impacts licenses and degrees: “The future stream of expected income, reduced to present value ... is obtained by reducing to present value, after taxes, the enhanced earning capacity created by the license or degree during the lifetime of the licensee ... an expert typically prepare[s] a projection of the licensee's lifetime earnings; if there is already an earnings history, that projection will be founded upon the past earnings history.” “Once a court converts a specific stream of income into an asset, that income may no longer be calculated into the maintenance formula and payout”; however, “[t]here is no double counting to the extent that maintenance is based upon spousal income which is not capitalized and then converted into and distributed as marital property.”

In *Fruchter v. Fruchter*,⁶ the Appellate Division, citing, *Grunfeld*, remitted the matter to Supreme Court because it had not made clear whether the maintenance award included amounts corresponding to portions of defendant's income that were capitalized for purposes of determining the distributive award.

The Court of Appeals⁷ has underscored that: (1) “the monetary value assigned to a license may not overlap with the value assigned to other marital assets that are derived from the license such as the licensed spouse’s professional practice,” and (2) “courts must be meticulous in guarding against duplication in the form of maintenance awards that are premised on earnings derived from professional licenses, to wit, distinguishing income that has been converted into and distributed as an asset from income that has not been converted and distributed.”

Keane v. Keane

In *Keane*, the husband was the sole shareholder in a real estate entity with two assets, one was a parcel leased to a car repair shop, providing monthly rental income, the other was a

⁵ *Sodaro v. Sodaro*, 286 A.D.2d 434 (2nd Dept. 2001), leave to appeal dismissed, 97 NY2d 677 (2001); *Wadsworth v. Wadsworth*, 219 A.D.2d 410 (4th Dept. 1996); see, also, *Phelps v. Phelps*, 199 A.D.2d 608 (3rd Dep’t 1993); *Erickson v. Erickson*, 281 A.D.2d 862 (3rd Dept., 2001); *Atwal v. Atwal* 270 A.D.2d 799 (4th Dept., 2000): The court valued defendant's enhanced earnings at zero to avoid making a duplicative award.

⁶ *Fruchter v. Fruchter* 288 A.D.2d 942 (4th Dept., 2001).

⁷ *McSparron v. McSparron*, 87 N.Y.2d 275 (1995).

mortgage note, also yielding monthly income. The wife used the market value approach to appraise the real property at \$324,000. The husband applied the capitalization of income method to fix its value at \$290,000 (adopted by the court), which method necessarily considered the monthly rental income throughout the lease term.

Supreme Court awarded: (1) the wife \$1,292 in monthly maintenance (to coincide with the end of the shop's lease term) plus the marital home, (2) the husband the shop property, and (3) the wife \$57,600 plus monthly payments of \$2,000 to distribute the value of the mortgage note as received over time.

Over a partial dissent by Justice Gloria Goldstein, the Appellate Division modified by deleting the \$1,292 monthly maintenance award, reasoning that it derived from "double counting" the husband's income from the rental property after that income had been included in the valuation of the property.⁸

The Court of Appeals credited Justice Goldstein's reasoning and reversed. Citing its own precedent rulings, *Grunfeld*⁹ and *McSparron*, the appeals court underscored that it had "already differentiated between a professional license and tangible income-producing property, because 'where a professional license is at issue, the asset is totally indistinguishable and has no existence separate from the projected professional earnings from which it is derived. Hence, a trial court must convert the enhanced earnings attributable to the license into a monetary marital asset to achieve equitable distribution. In contrast, a court can transfer title to real or personal property in order to equitably distribute the asset.'" An intangible asset cannot be sold – it can only be utilized by the holder who makes more money with this asset than without it.

Significantly, *Keane* emphasized, as did Justice Goldstein, that an inquiry into double counting should not "depend on the valuation method used. After all, any valuation of an income-producing property will necessarily take into account the income-producing capacity of that property." Justice Goldstein explicated that the valuation methodology "does not alter the tangible nature of the asset, nor should it deprive the plaintiff of maintenance based upon the defendant's cash flow derived from the business":

... the rental property remained a discrete asset with marketable value which the defendant retained as part of his distributive award. Therefore income from that asset was properly included in the calculation of maintenance, just as investment income from assets awarded to a spouse as part of equitable distribution of property may be considered in awarding maintenance.

If the higher market value approach had been used, there would undoubtedly be no argument with respect to "double counting" ... [because] its status as "passive

⁸ *Keane v. Keane* 25 A.D.3d 729 (2nd Dept., 2006).

⁹ *Grunfeld v. Grunfeld*, 94 N.Y.2d 696 (2000).

not transferable. Business Goodwill can be defined as an income stream that is transferable at Fair Market Value.

New York is the only state which values and distributes licenses and other enhanced earning capacity attained during a marriage. Many states do not value and equitably distribute personal goodwill.

Is the Court now stating that where there is Personal Goodwill (not saleable), that any income generated from such Personal Goodwill is not to be considered when calculating maintenance? Conversely, is the Court stating that only where there is Business Goodwill, real property and other tangible assets, that income generated from these “real” assets be considered in maintenance calculations? If this is the case, then how much of the income generated from Business Goodwill should be available for maintenance – under certain circumstances it may be all and in other circumstances it may be none. Consider the following examples and the questions that need be asked:

Example 1: After trial, the court has awarded a wife the marital home with a Fair Market Value of \$1 million (mortgage free). The husband is awarded commercial property also with a Fair Market Value of \$1 million (mortgage free). The commercial property generates net rental income of \$75,000 per year.

- Should the \$75,000 of income generated by the husband’s commercial property be available for maintenance (no children)?
- If renting and managing the commercial property is the husband’s business, should he be entitled to reasonable compensation for his services, and only the income in excess of reasonable compensation be available for maintenance?
- The wife lives rent-free in the house which was awarded to her. The husband has an investment in commercial real estate, but no place to live. Is this equitable?

Example 2: A spouse owns a manufacturing business that can be sold. There is industry market data available which can be utilized to value the Company. Valuation experts value the business using market multiples of Price to Revenue and Price to Earnings. They also value the business using an Excess Earnings method as a “sanity” check. How much income is available for maintenance without double-dipping?

- All income because the business can be sold at a multiple of revenue.
- Income in excess of reasonable compensation because all income in excess of reasonable compensation was already included in determining the value utilizing the Income Approach (market value) and the Excess Earnings approach as a “sanity” check.
- If there was a hypothetical sale of a business, wouldn’t the seller theoretically only be able to earn reasonable compensation at another job?

The issue of the “real” Fair Market Value of an asset as compared to using Value to the Owner as a proxy for value has once again clouded the issue as to what constitutes double-dipping. In fact, experts utilize the assumption of a hypothetical sale in their determination of Fair Market Value. There is no sale contemplated, there is no assurance that the company can or will be sold for that amount. Therefore, in the matrimonial dispute, Fair Market Value itself is a proxy for value in order to equitably distribute the asset. Should it make a difference whether the asset is valued to the holder or Fair Market Value in determining the maintenance issue when the value of that asset has been quantified and distributed? In the final analysis, valuation of an income producing asset is nothing more than a forecast of the future performance and the income stream of the company. Therefore, irrespective of the valuation methodology, income has been captured and distributed.

Conclusion

Keane compels us to examine the issue of available income for spousal maintenance under a fresh lens. Has the the Court of Appeals created a new category of asset where the income is available for maintenance as it created a new breed of asset when it created enhanced earning capacity in *O'Brien v. O'Brien*¹⁰? What was seemingly easy before when representing the recipient spouse no longer is and, as clearly demonstrated by the examples herein, expert advice may be required for what appears to be seemingly routine assets.

¹⁰ *O'Brien v. O'Brien*, 66 N.Y.2d 576 (1985).