



Oh No...I Just Got Served with a Divorce Summons... How to Value Your Practice

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When medical professionals get served with a divorce summons, their first call should be to a divorce lawyer and the next, to their accountant. Why? Because unlike other professionals who work for a company, doctors typically have their own practice, building, equipment and staff, where they earn additional revenue and profits, and may even have an interest in a professional limited liability company or clinic. To the Tennessee courts, all these items are assets that need to be valued.

Tennessee divorce law requires that the courts classify the assets as 'marital' or 'separate' assets.¹ Typically, those assets owned prior to marriage are separate and not included in the Court's division of the assets. However, if a party commingles the asset or transmutes the asset to change its identity to marital, then the court will consider that asset to be marital subject to division at trial.² A separate asset that appreciates in value over the course of the marriage may be subject to division, if the other spouse has substantially contributed to the separate asset's appreciation.³ Therefore, if a doctor owned his practice before the marriage, the evaluator will need to determine the value of the practice at the time of marriage and then at the time of the divorce. The increase in value is what the Court will consider.⁴

Marital property is all property, real and intangible, that is acquired during the marriage through the date of the divorce.⁵ It matters not if the title to the asset is in one spouse's name alone or in joint names.

What is needed to value a medical practice? A specialized business valuation analyst or appraiser will need to review financial records⁶ to establish income, compare the income over five years, and determine the value of the asset. In Tennessee, the Courts have generally regarded the valuation process as 'not an exact science,' so each party bears the burden of producing competent evidence regarding the valuation of a marital asset.⁷ The Courts weigh and evaluate all relevant evidence, including what the doctor believes the practice is worth.⁸ Therefore, you should be careful when listing the practice value on a financial statement given to a bank for a loan or to an insurance agent for life insurance, as the Court will consider those values. The Courts may also examine the methodology used by the evaluator.⁹

There are three approaches to value a professional practice. Typically, the "net asset" method is used to value the practice.¹⁰ Under the net asset method, the value of the professional practice is ascertained by taking the accounts

receivables multiplied by a percentage of collections, subtracted by the accounts payable. That number is then added to the current fair market value of the equipment along with the value for patient records. The result is a 'book value' of the practice.¹¹

A second approach is to examine the buy-sell agreement¹² and determine the "market" value of the practice (or portion thereof). There are also resources to show the compensation and productivity of doctors in certain geographical areas.¹³ The last approach which has some merit depending on the facts of a case is the "income" approach or excess earnings approach. The evaluator would value not only the tangible assets, but the intangible assets.¹⁴ This approach has been used by Courts in Tennessee when the doctor can generate additional profits beyond their salary from equipment and staff.¹⁵

It is important to work with your attorney and accountant early in the process, because the sooner these documents are provided, the quicker the accountant can determine the value, and the sooner the divorce can be resolved, so you can go back to doing what you do best...treating patients!

Endnotes

1. TCA 36-4-121
2. TCA 36-4-121. *Langschmidt v. Langschmidt*, 81 S.W. 3d 741 (Tenn. 2002).
3. TCA 36-4-121 (b)(1)(B).
4. *Cutsinger v. Cutsinger*, 917 S.W. 2d 238 (Tenn. App. W.S. 1995), appeal denied.
5. TCA 36-4-121(a)(3)(C).
6. Financial records to be produced should include tax returns, K-1s, Schedule Cs, and supporting documents, corporate minutes, organizational documents, stock register, bank statements (business and personal), credit card statements (business and personal), payroll records, financial statements, profit and loss statements, income statements, buy-sell agreements, life insurance policies, profit sharing and deferred compensation plans for the last five years; and current account receivables, account payables, schedule of equipment register, work in progress, cash, and appraisals on any real estate owned by the practice.
7. *Wallace v. Wallace*, 733 S.W. 2d 102 (Tenn. App. 1987).
8. *Dailey v. Bateman*, 937 S.W. 2d 927 (Tenn. Ct. App. 1996).
9. *Powell v. Powell*, 124 S.W. 3d 100 (Tenn. App. April 7, 2003), perm. denied.
10. *Smith v. Smith*, 709 S.W. 2d 588 (Tenn. 1985).
11. *Hazard v. Hazard*, 833 S.W. 2d 911 (Tenn. App. WS 1991) appeal denied.
12. "A Buy-sell agreement usually provides for the purchase of a business entity or for the remaining principal's purchase of the withdrawing party's share at a predetermined price." Orenstein and Skoloff, *When a Professional Divorces: Strategies for Valuing Practices, Licenses, and Degrees*, (ABA, 1998), page 27.
13. *Physician Compensation and Production Survey*, published by Medical Group Management Association Center for Research and Ambulatory Health Care Administration.
14. Those intangible assets are items such as, how many patients have been built up, how many hours it took to take all of the history and physical information, how many hours of training does the staff have, how profitable is the practice without the doctor being there, what can be charged for services that the doctor did not perform.
15. *Witt v. Witt*, 1992 WL 52746 (Tenn. Ct. App. 1992).
York v. York, 1992 WL 181710 (Tenn. Ct. App. 1992).