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STATE OF MINNESOTA
IN COURT OF APPEALS
A13-0244

In re the Marriage of:
Jeffrey Scott Hamelink, petitioner,
Appellant,

vs.

Bonnie Jean Marie Hamelink,
Respondent.

Filed December 30, 2013
Affirmed in part, reversed in part, and remanded
Kirk, Judge

Scott County District Court
File No. 70-FA-10-12284

Robert J. Hajek, Donald L. Beauclaire, Hajek & Beauclaire, L.L.C., Minnetonka, Minnesota (for appellant)

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Considered and decided by Hudson, Presiding Judge; Stoneburner, Judge; and Kirk, Judge.

U N P U B L I S H E D   O P I N I O N

KIRK, Judge

Husband challenges the district court's division of property in a marital dissolution, arguing that the district court failed to adequately explain why a hypothetical

buyer's personal tax liability was not considered in valuing his business, erred in valuing his business without considering a hypothetical buyer's personal tax liability, and erred in awarding wife a share of his anticipated personal tax refund. We affirm in part, reverse in part, and remand for proper equitable distribution based on a correct allocation of the tax refund.

FACTS

Appellant-husband Jeffrey Scott Hamelink and respondent-wife Bonnie Jean Marie Hamelink separated in March 2010. During the marriage dissolution proceeding, the parties argued over the allocation of property worth a total of over ten million dollars. After a four-day trial, the district court rendered its decision in September 2012. Both parties moved to amend the order, focusing on two items: the value of husband's business and the allocation of husband's anticipated personal tax refund.

Husband founded North Star Machine Co., d/b/a/ Stealth Manufacturing, in 1979. The company designs and manufactures custom metal gas-burner equipment for use in fireplaces, grills, furnaces, and commercial ovens. The company is organized under Subchapter S of Chapter 1 of the Internal Revenue Code, with husband as the sole owner. An S corporation such as North Star does not pay corporate taxes, but the owners of such corporation are liable for personal taxes on the corporate profits. The parties disagreed about the fair market value of the company as of the valuation date, and the district court heard expert witnesses from each side.

Husband's expert, Stephen Hosch, utilized the single-period capitalization method while "tax affecting" estimated future earnings to calculate a fair market value of

$2,285,000. Tax affecting is the technique of valuing S corporations by considering the effect of a hypothetical buyer's personal tax liability on estimated earnings. This technique is implemented by calculating and applying a hypothetical tax rate, which effectively lowers estimated future earnings and the fair market value derived from such earnings. Wife's expert, Arthur Cobb, utilized the discounted-cash-flow method without tax affecting and valued the company at $6,500,000. The district court adopted Cobb's method but adjusted some of the component values not relevant to this appeal. With these adjustments, the district court valued North Star at $3,666,960.

During the dissolution proceeding, husband overpaid his 2011 federal taxes by $470,130 and Minnesota state taxes by $156,942. The district court made no findings as to any bad faith conduct by husband, but it found that the overpayment was "an asset of the business," so it allocated the anticipated tax refund equally between the parties.

This appeal follows.

D E C I S I O N

I.

Husband first argues that the district court erred by failing to adequately explain its refusal to consider a hypothetical buyer's personal tax liability in valuing his business. Husband asserts that remand is necessary because the district court's findings "merely describe the evidence and testimony" and "did not explain the reason for its conclusion." We disagree.

Findings of fact should be adequate to "satisfy the litigants that their case was fairly resolved, and permit reasoned appellate review." *Hesse v. Hesse*, 778 N.W.2d 98,

104 (Minn. App. 2009). "Reciting the parties' claims may be helpful in understanding what the [district] court considered in making its findings; however, the findings themselves must be affirmatively stated as findings of the [district] court." *Dean v. Pelton*, 437 N.W.2d 762, 764 (Minn. App. 1989). The district court's valuation of property "should be supported by either clear documentary or testimonial evidence *or* by comprehensive findings issued by the court." *Ronnkvist v. Ronnkvist*, 331 N.W.2d 764, 766 (Minn. 1983) (emphasis added).

Here, the district court adopted Cobb's method of calculating fair market value without tax affecting. Cobb's valuation report included citations to cases that have opposed tax affecting, and he testified as to his decision not to tax affect. Accordingly, the district court's decision is supported by clear documentary and testimonial evidence. Although the district court did not expressly articulate its reason for adopting Cobb's position, "[w]hen evidence relevant to a factual issue consists of conflicting testimony, the district court's decision is necessarily based on a determination of witness credibility, which we accord great deference on appeal." *Alam v. Chowdhury*, 764 N.W.2d 86, 89 (Minn. App. 2009). The district court found Cobb to be more persuasive, and remand is not necessary because the district court's findings were adequate and permit reasoned appellate review.

II.

Husband next argues that the district court made an erroneous valuation of his company. "Assigning a specific value to an asset is a finding of fact." *Hertz v. Hertz*, 304 Minn. 144, 145, 229 N.W.2d 42, 44 (1975).

> [D]isputes as to asset valuation are to be addressed to the trier of fact, and conflicts are to be resolved in that court. Such findings of fact, when made without a jury, shall not be set aside unless clearly erroneous on the record as a whole.
>
> Furthermore, valuation is necessarily an approximation in many cases, and it is only necessary that the value arrived at lies within a reasonable range of figures. Thus, the market valuation determined by the trier of fact should be sustained if it falls within the limits of credible estimates made by competent witnesses even if it does not coincide exactly with the estimate of any one of them.

Id. (citations omitted). "A finding is clearly erroneous if the reviewing court is left with the definite and firm conviction that a mistake has been made." *Vangsness v. Vangsness*, 607 N.W.2d 468, 472 (Minn. App. 2000) (quotation omitted). The determination of whether to value an asset using its after-tax value is reviewed for an abuse of discretion. *Maurer v. Maurer*, 623 N.W.2d 604, 608 (Minn. 2001).[1]

Here, husband argues that the district court erred by refusing to tax affect and to consider a hypothetical buyer's personal tax liability in valuing his business, which allegedly resulted in an overvaluation of approximately $700,000. On this record, we cannot agree that the district court abused its discretion and that the valuation was clearly erroneous. Indeed, the district court adopted Cobb's method which did not tax affect, therefore its valuation "falls within the limits of credible estimates made by competent witnesses." *Hertz*, 304 Minn. at 145, 229 N.W.2d at 44. Husband never challenged the

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[1] We note that *Maurer* addressed the issue of whether a district court may consider the parties' potential tax consequences of its award when dividing marital property in marriage dissolution cases, 623 N.W.2d at 606–09, which is different from the issue of whether a district court erred in refusing to consider a hypothetical buyer's potential tax consequences in a hypothetical sale of an S corporation.

admissibility of Cobb's testimony. And, Cobb's method is supported by the record. No Minnesota appellate courts have opined on this issue, but Cobb relied primarily on a U.S. Tax Court decision affirmed by the U.S. Court of Appeals for the Sixth Circuit, as well as a Minnesota district court decision, to support his position that value should be determined without tax affecting.

In *Gross v. Commissioner*, the U.S. Tax Court had to determine the fair market value of a gift of stocks for a bottling company formed as an S corporation. 78 T.C.M. (CCH) 201, at *1, *12 (1999), *aff'd*, 272 F.3d 333 (6th Cir. 2001) (Cohn, J., concurring in part, dissenting in part).[2] The taxpayer advocated for the tax affecting method and "introduced a fictitious tax burden, equal to an assumed corporate tax rate of 40 percent, which he applied to reduce each future period's earnings, before such earnings were discounted to their present value." *Id.* at *4. But the tax court was not persuaded, and it explained:

> We believe that the principal benefit that shareholders expect from an S corporation election is a reduction in the total tax burden imposed on the enterprise. The owners expect to save money, and we see no reason why that savings ought to be ignored as a matter of course in valuing the S corporation.

Id. at *10.

On appeal, the Sixth Circuit "point[ed] out the different ways the experts approached the valuation question to the facts at hand." *Gross*, 272 F.3d at 355. The appellate court acknowledged that the tax court "found that [the commissioner's expert]'s method was the better reasoned one under the facts and circumstances of the case" and

[2] Judge Cohn's opinion represents the Sixth Circuit's opinion on the tax affecting issue.

therefore did not find clear error. *Id.* Subsequent to *Gross*, the U.S. Tax Court has repeatedly refused to tax affect estimated earnings in determining the fair market value of an S corporation. *See, e.g.*, *Estate of Gallagher v. Commissioner*, 101 T.C.M. (CCH) 1702, at *12 (2011) ("[W]e will not impose an unjustified fictitious corporate tax rate burden on [the company's] future earnings.").

In addition to relying on the U.S. Tax Court decision, Cobb also relied on a Minnesota district court case, *Doerr v. Arundel*, No. EM 97-013502, slip op. at 21 (Minn. Dist. Ct. Oct. 1, 1999). There, the district court had to value an S corporation in "a forced buy-out valuation procedure." *Id.* at 1. As in *Gross*, the district court was presented with expert opinions to either tax affect at a hypothetical full corporate rate of 40% or to not tax affect at all, and it decided not to tax affect. *Id.* at 21. The district court did not address the effect of a hypothetical buyer's personal taxes but explained its decision in terms of a hypothetical seller's willingness to sell:

> If the court makes [the] assumption, that this is a hypothetical sale, it appears from the evidence that it is much more likely that the sale of this company would be to another subchapter S corporation. With this in mind, it only makes sense for the court to conclude that it is unlikely that a willing seller would choose to sell the business to a C corporation instead of an S corporation, for less than the business is worth to the seller. A C corporation would be less likely to be able to negotiate a sale, because the business would be more valuable in the hands of another subchapter S corporation or existing owners. [Defendants' expert] could offer no evidence that a sale of [the company] to a C corporation was more likely than a sale to an S corporation.

Id.

In view of these cases, Cobb testified that he adopted the U.S. Tax Court's and Minnesota district court's position to not tax affect in valuing husband's business. In light of this testimonial and documentary support, we cannot conclude that the district court abused its discretion by adopting Cobb's method, and we cannot say with a definite and firm conviction that the district court's valuation fell outside a reasonable range of figures. "By merely accepting one of two proffered appraisals, the [district] court cannot be said to have erred." *Letsch v. Letsch*, 409 N.W.2d 239, 242 (Minn. App. 1987).

Husband argues that "[i]n the context of divorce, national case law makes clear that in order to arrive at an accurate value, the [c]ourt must tax affect the business." Although husband overstates the level of support for tax affecting, his position has some weight. Husband advocates for a hybrid tax-affecting approach, which has its genesis in *Delaware Open MRI Radiology Associates, P.A. v. Kessler*, 898 A.2d 290 (Del. Ch. 2006).

In *Kessler*, the Delaware Court of Chancery had to determine "whether the minority stockholders of [an S corporation] received fair value in a squeeze-out merger with an acquisition vehicle of the majority stockholders." *Id.* at 299. As in *Gross* and *Doerr*, the Delaware court was presented with one expert's opinion to tax affect at a hypothetical full corporate rate of 40% and another expert's opinion to not tax affect at all. *Id.* at 326. Instead of entirely adopting one method over the other, the Delaware court developed its own hybrid model, reasoning that "neither of the experts has taken the most reasonable approach." *Id.*

The Delaware court first rejected tax affecting at 40% because doing so would ignore the benefit of corporate tax avoidance afforded to the owners of S corporations, and thereby undervalue the business:

> If an S corporation is to be sold, . . . it will receive no premium over a C corporation if the universe of buyers is principally comprised of C corporations. There is an obvious reason for this: unless the buyer of the S corporation can retain and benefit from that tax status, then the buyer will value an S corporation at the value it would have as a C corporation. Therefore, it would be highly misleading to do a market-based comparable acquisition valuation of an S corporation using sales of comparable C corporations to C corporations, and then assume that the S corporation would be sold at a higher price because of its tax status.

Id. at 327 (footnote omitted). The Delaware court then observed that, "[i]n coming to a determination of how the [minority shareholders'] interest in [the company] would be valued in a free market comprised of willing buyers and sellers of S corporations, acting without compulsion, it is essential to quantify the actual benefits of the S corporation status." *Id.* at 328.

The Delaware court also rejected the idea of not tax affecting at all because doing so would ignore personal taxes that S corporation owners must pay on corporate profits, and thereby overvalue the business:

> The Internal Revenue Code states that "[t]he taxable income of an S corporation shall be computed in the same manner as in the case of an individual . . . ." This tax, though assessed at individual rather than corporate tax rates, is dependent solely upon the corporation's net earnings. Even if [the company] were to retain 100% of its earnings annually, its stockholders still would owe taxes on [corporate] income even though they received no distributions. Affording a remedy to the [minority shareholders] that denies the reality

> that each shareholder owes taxes on his proportional interest in [the company] would result in the [minority shareholders] receiving a higher per share value from the court than it could ever have realized as a continuing shareholder.

Id. (footnote omitted). Accordingly, the Delaware court decided that:

> To ignore personal taxes would overestimate the value of an S corporation and would lead to a value that no rational investor would be willing to pay to acquire control. This is a simple premise—no one should be willing to pay for more than the value of what will actually end up in her pocket.

Id. at 329 (footnote omitted).

After rejecting both methods, the Delaware court developed a hybrid tax affecting model by first calculating a cash flow with no corporate taxes and a 40% personal tax rate, and then using this cash flow and a 15% personal dividend tax rate to back into a hypothetical corporate tax rate equal to 29.4%. *Id.* at 330.

The *Kessler* model was subsequently adopted by the Supreme Judicial Court of Massachusetts in *Bernier v. Bernier*, 873 N.E.2d 216 (2007). There, the Massachusetts supreme court had to value the parties' supermarket business organized as S corporations in order to determine an equitable distribution of properties in a marriage dissolution. *Id.* at 225. The trial court had adopted the husband's valuation which tax affected at a hypothetical full corporate rate of 35%. *Id.* at 228. The Massachusetts supreme court reversed and held that "doing so was not reasonable, as it would clearly produce an arbitrary result: a significant undervaluation of the supermarkets." *Id.* The Massachusetts supreme court concluded that the hybrid tax-affecting method provided a "fairer mechanism for accounting for the tax consequences of the transfer of ownership

of the supermarkets from one spouse to the other in the circumstances of record." *Id.* at 231.

In light of *Kessler* and *Bernier*, we agree with husband that there is support for Hosch's decision to tax affect. But applying our standard of review, husband must convince us not only that tax affecting is reasonable, but also that the district court's refusal to tax affect was unsupported by any evidence and was an abuse of discretion. And as to the latter, husband's effort fails. Indeed, Hosch admitted in his valuation report and during his testimony that the issue of tax affecting is an open debate. Husband attempts to distinguish *Gross* and *Doerr* because they were decided outside of the marriage-dissolution context while *Bernier* was a marriage-dissolution case. But this superficial distinction matters not to the heart of the issue because all of the cases that have discussed tax affecting involved the same purpose of determining the value at which a business would change hands between a hypothetical willing buyer and a hypothetical willing seller. In fact, the *Bernier* decision, on which husband relies, cited *Gross* for its definition of fair market value. *Id.* at 222 n.8 ("'Fair market value' is generally defined as the 'price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.'").

Husband argues that ignoring the economic reality that an S corporation owner will pay personal taxes on corporate profits leads to an overvaluation because an investor would purchase the corporation with after-tax funds and would account for personal tax liability in the valuation. But, for the valuation of C corporations, the practice of ignoring

the effect of personal tax liability "has been generally accepted by the courts, the IRS and the valuation profession for decades." Keith F. Sellers & Nancy J. Fannon, *Valuation of Pass-Through Entities: Looking at the Bigger Picture* 2 (2011). Therefore, we do not find it unreasonable to employ the same practice for the valuation of S corporations in a hypothetical transaction. Whether to do so is for the experts to explain, the parties to prove, and the district courts to decide.

Finally, husband contended at oral argument on appeal that our affirmance of the district court would result in Cobb testifying in all future marriage dissolution litigation, and no district court would ever find tax affecting to be appropriate. We disagree.

As an error-correcting court, we hold only that the district court did not clearly err in refusing to tax affect under the particular circumstances of this case. Our decision should not be interpreted as suggesting that tax affecting should never be considered. In fact, we note that wife mistakenly argued that "[t]here is an abundance of United States Tax Court case law indicating that hypothetical tax burdens are not a basis for manipulating a company's value." We do not read the U.S. Tax Court's decision in *Gross* as reaching this bright-line rule. Indeed, *Gross* actually advocated for tax affecting under the right circumstances:

> If, in determining the present value of any future payment, the discount rate is assumed to be an after-shareholder-tax rate of return, *then the cash-flow should be reduced ("tax affected") to an after-shareholder-tax amount.* If, on the other hand, a presharehoIder-tax discount rate is applied, no adjustment for taxes should be made to the cash-flow.

78 T.C.M. (CCH) 201, at *11 (emphasis added). The tax court, therefore, was really only

concerned with matching the tax characteristics of the discount rate and cash flow, which is sound economic principle. A district court facing the same issue of tax affecting in the future is certainly within its discretion to consider cases such as *Gross*, *Kessler*, and *Bernier*, to decide whether tax affecting is appropriate under the circumstances.

III.

Finally, husband argues that the district court erroneously awarded wife a share of his anticipated tax refund due to a prior overpayment.

> Whether property is marital or nonmarital is a question of law, but a reviewing court must defer to the [district] court's underlying findings of fact. However, if [this court is] left with the definite and firm conviction that a mistake has been made, [it] may find the [district] court's decision to be clearly erroneous, notwithstanding the existence of evidence to support such findings.

See Olsen v. Olsen, 562 N.W.2d 797, 800 (Minn. 1997) (citation and quotation omitted).

The district court found:

> The [c]ourt understands that the "overpayment" amount was paid from company funds and therefore its refund would add value back into the final value for the company. Because there [were] conflicting assertions about the amount of the overpayments and what was anticipated to be refunded, the [c]ourt shall treat the overpaid taxes independently and order that any tax refund based on overpayments made prior to the dissolution shall be shared equally between the parties.
>
> . . . .
>
> During the pendency of these proceedings, [husband] overpaid federal taxes by $470,130 and Minnesota State taxes by $156,942. These monies are an asset of the business and must be shared equally unless they are applied to outstanding tax obligations that accrued during the course of the marriage.

Husband contends that he used his own income—not company assets—to fund the tax overpayment, and because the district court had ordered that wife is not entitled to marital income during the pendency of this action,[3] husband's anticipated tax refund is not marital property subject to allocation. We agree.

The evidence does not support the district court's finding that the $627,072 tax overpayment was "an asset of the business" and "its refund would add value back into the final value for the company." Indeed, husband, as the sole owner of an S corporation, is entitled to receive an income comprised of his salary and company profits. Hosch testified that adding in $627,072 worth of cash into the company would not increase the overall value of the company because that cash would ultimately be accounted for as company profit generated as income to husband. Moreover, wife's own proposed property settlement schedule allocated the overpayment to husband. Significantly, wife offers no documentary or testimonial evidence to support the district court's finding. The only part of the record which we find to support the district court's position is wife's counsel's argument at the hearing that "had [husband] not taken [the overpayment] out of the company . . . that asset would have been worth that much more." But this assertion is contrary to Hosch's testimony, and the "arguments of attorneys are not evidence." *State v. McCoy*, 682 N.W.2d 153, 158 (Minn. 2004) (quotation omitted).

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[3] Generally, "marital property includes property acquired by the parties between their separation and final decree." *Fastner v. Fastner*, 427 N.W.2d 691, 699 (Minn. App. 1988). But wife has not appealed the district court's ruling that she is not entitled to marital income during the pendency of this action.

Wife claims that husband's argument is "a series of shell games," and she argues that the funds used for the overpayment were once "in North Star." But the district court made no findings as to any bad faith conduct on husband's part, and wife fails to point to any record evidence to support her assertion. Additionally, even if the funds were once "in North Star," husband was entitled to company profits as the sole owner of that S corporation.

We are left with a definite and firm conviction that the district court erred in awarding wife a share of husband's anticipated tax refund. Accordingly, we remand for proper equitable distribution of marital assets based on an allocation of the tax refund to husband. On remand, the district court has discretion to determine whether, and what, additional issues should be considered to reach a proper equitable distribution and spousal maintenance award in light of the reallocated tax refund.

IV.

Finally, wife argues that husband's brief should be stricken for failure to adequately cite to the record. "The supreme court has concluded that in some circumstances it is a flagrant violation of the rules to fail to provide citations to the record." *Cole v. Star Tribune*, 581 N.W.2d 364, 371 (Minn. App. 1998.) Husband omitted citations on only a few occasions, which is not a flagrant violation of the rules.

Affirmed in part, reversed in part, and remanded.