The *Orgler* Decision: What It Means and How to Use It

*by Frank A. Louis**

In Orgler v. Orgler, 237 N.J. Super. 342 (App. Div. 1989), the Appellate Division, conclusively and definitively, determined that theoretical tax consequences must be "considered" by courts in effectuating a distribution of assets that is truly equitable. *Orgler*, however, makes it clear that the statutory directive mandating consideration does not mean deduction.

> We adopt as sound the common theme found in each of these out-of-state cases, that hypothetical tax consequences upon the future sale or transfer of marital assets should not be deducted from present value for equitable distribution purposes. See *Orgler* at 355.

This well-written and cogently reasoned decision has been criticized by certain lawyers as being unclear, contradictory, and injecting uncertainty into equitable distribution. Yet, it is not the decision that creates uncertainty but the misinterpretation of the clear meaning of what is, most certainly, one of the five most important matrimonial decisions ever decided.

Analyzing *Orgler*

The purported problem with *Orgler* is the criticism that the decision on one hand mandates that tax consequences be *"considered"* but that theoretical taxes cannot be *"deducted."* The confusion is created by mixing two separate and very distinct concepts — distribution and valuation. *Orgler* is not a valuation case but a critically important distribution case. Confusing the concepts of valuation and distribution is as egregious an error as failing to distinguish alimony and equitable distribution.

Orgler itself illustrates the point clearly. As Judge Havey carefully pointed out, Mr. Orgler argued "that the trial court erred in refusing to *deduct* from the value of the marital estate $1.2 million in hypothetical taxes." See *Orgler* at 352. Any confusion relates to the difference between *consideration* of future taxes and deducting from a gross number a future, but hypothetical, tax obligation.

As Judge Havey properly concluded, New Jersey law is, and always has been, quite clear that legitimate tax consequences must be considered if an equitable and fair distribution of assets is to be effectuated. See *Orgler* at 352-353. The seminal case of Painter v. Painter, 65 N.J. 196, 212-213 (1974) specifically held that it would "not be improper for a judge to give appropriate heed to legitimate tax considerations." That statement was, unfortunately, sufficiently ambiguous to permit argument over whether you deduct or consider those "legitimate tax considerations." Nor did the court, in either *Painter* or *Dugan*, provide any explanation as to what it meant by giving "appropriate heed to legitimate tax consequences." Significantly, the *Painter* decision specifically spoke about tax consequences "in effecting the *allocation* itself," emphasizing the distinction between distribution and valuation.

In Dugan v. Dugan, 92 N.J. 423, 441 (1983), a decision involving valuation of a law partnership, the court curtly noted that "potential federal tax consequences should be considered in determining equitable distribution." The manner in which that consideration was to be given was never explained or, unfortunately, discussed. A number of practitioners, as well as prominent accountants, interpreted the term "consideration" to mean that theoretical taxes must be deducted. *Orgler* unequivocally means that it is error to automatically equate *consideration* and *deduction*. Phrased differently, *automatic* deduction of theoretical tax consequences from the gross equitable distribution value is now error. See *Orgler* at 355.

It was particularly unfortunate that an issue arising in literally every dissolution case was susceptible of such differing interpretations. It adversely impacted on settlement and resulted in negotiated settlements and judicial determinations that were widely disparate and hence ultimately unfair. *Orgler*, by dealing with the term *consideration* should eliminate determinations adversely affecting the dependent spouse since automatic *deduction* of theoretical tax consequences had the effect of reducing the *value* of distributable assets. As such, the dependent spouse invariably received a lesser equitable distribution award.

The *Stern* case

While the Supreme Court in *Painter* and *Dugan* raised the issue, it did provide guidance in Stern v. Stern, 66 N.J. 340, 348 (1975) which dealt with the distributability of accounts receivable. *Stern* stands for the proposition that accounts receivable are a separate and distinct element of value in determining the total value of a professional practice. The court expressly rejected the husband's arguments, cogently advanced, that: (a) it was unfair not to diminish accounts receivable for anticipated income taxes; and, (b) that receivables were simply a future income stream utilized for payment of support and, hence, were not distributable assets. In *Orgler* terminology, the argument was that accounts receivable should be tax affected, i.e. the hypothetical taxes *deducted*, since they clearly were not speculative and would be incurred virtually immediately.

The court found accounts receivable to be assets and refused to reduce them for future income taxes. Yet, the court carefully explained these future taxes "may be a relevant consideration when considering whether a *distribution* is equitable" thus emphasizing the distinction between *valuing* an asset and the manner in which it is distributed. This important distinction is what causes *Orgler* to be misinterpreted,

thus illustrating why the court's message in *Stern* seemingly has been lost in the art of equitable distribution. Yet, careful practitioners treat a professional practice not as a fungible entity for equitable distribution. Instead, they request the court treat the differing elements of value differently in terms of percentages. Or, using *Orgler* terminology, if the court felt the non-titled spouse was entitled to 40 percent of the professional practice, the percentage applied to *distributing* (not *valuing*) account receivables should be different since tax consequences had to be considered.

It is incorrect to simply analyze a professional practice as an entity, even if it is tax-affected, because the tax impact on the accounts receivable may be different than with good will. It is more certain that accounts receivable will be taxed at a specific rate and at a specific point in time than the good will whose actual sale is entirely more theoretical. In other words, it is likely and perhaps inevitable that collected accounts receivables will be taxed. It is not as likely, and may be entirely speculative, that the fixed assets and good will will ever be taxed. In this context, *Orgler* is consistent with *Stern* — both focus not on valuation but on "allocation" or "distribution."

Presenting proof

It is patently clear that it is counsel's obligation to present competent proof as to valuation of assets. See Rothman v. Rothman, 65 N.J. 219, 233 (1974). It is equally clear that counsel has the obligation to present competent proof on what the theoretical tax consequences are, i.e. the amount of tax incurred if the assets were sold as of the valuation date. Attorneys in the typical case understand the responsibility of presenting the court with a valuation of a marital home or a business. What *Orgler* makes clear is that attorneys equally have the responsibility of presenting a specific dollar figure as to the potential tax impact of a distribution since, without that number, a court cannot make a judgment how, if at all, these future and theoretical taxes should be treated.

In reviewing *Orgler*, the discussion most frequently focuses on whether the theoretical taxes are "speculative." Counsel representing non-titled spouses use the speculative defense alleging that since the tax consequence is not presently being incurred, it should not be *considered*. In response, counsel for the titled spouse argue that *Orgler* mandates consideration of theoretical tax consequences and, therefore, they should be *deducted*. Both arguments are incorrect and inherently unfair. The true issue is the manner in which the distribution is made or how the percentage of the asset awarded is impacted by a tax not presently being incurred but for which a future liability exists. Counsel's ability to fashion arguments directly dealing with why, or why not, these future liabilities should be considered is now, after *Orgler*, critical.

Thus, a court is not only considering tax consequences as mandated by *Stern*, *Dugan* and *Painter*, but it is also complying with the recently adopted statute which specifically provides that "the tax consequences of the proposed distribution to each party" must be considered. See N.J.S.A. 2A:34-23.1(j). A court is not therefore, impermissibly, in *Orgler* terminology, *deducting* theoretical tax consequences but, quite properly, following the directive of the Supreme Court and the Legislature in equitably *considering* the tax consequences, among the other statutory factors, in the overall distribution scheme. The mechanism used in this consideration is the *percentage* awarded — not the *value* of the asset. Implementation of *Orgler's* mandate does not merely require a calculator — rather, it requires the careful analysis of all facts in the case tempered by the exercise of the court's sound discretion in selecting the proper percentage.

Theoretical taxes

There is no decision setting forth standards by which a court is to consider theoretical taxes on the distribution issue. Clearly, the more speculative, or further in the future, the tax consequences might be, the less the impact on the percentage. If the tax is so far in the future, or so speculative that it might never be imposed, it may have no impact at all. Yet, the larger the potential tax impact, or the more certain the taxes will be incurred on sale, the greater consideration in the percentage. (See *Louis*, "Consideration of Theoretical Tax Consequences in Equitable Distribution," 8 *New Jersey Family Lawyer* 153 (1989), discussing the various arguments either party may advance regarding the consideration of theoretical taxes in equitable distribution.)

Thus, in the first instance, the inquiry must be whether the asset is to be sold either by the voluntary act of the parties or by virtue of the court's equitable distribution scheme. An asset directed to be sold to raise cash must have its theoretical tax considered directly by the court since these are no longer theoretical but actual. Where the parties agree to liquidate appreciated stock, the taxes that will be incurred must be considered. On these facts, consideration should be equated with deduction yet such clear cut cases are rare. The more difficult question is where the party maintaining the asset intends to keep it. In that circumstance there are two important factors: the age of the recipient spouse and the amount of the theoretical tax. The older the owner is, the more likely the asset will be sold. The greater the amount of the theoretical tax, the more unfair it is not to have that liability "considered" in the percentage allocation. What were the expectations of the marital partnership? Did they plan to sell at a particular point? These questions, like all equitable distribution issues, are extremely fact sensitive. There is certainly a vast difference in how a court should distribute a $500,000 asset with $150,000 in theoretical taxes if the recipient is 35 years old with no desire to sell as opposed to a 60-year-old owner where the marital partnership (and the owner after the divorce) intended to sell the

asset at age 62 1/2. Yet, the degree to which these taxes may be avoided by legitimate tax planning may equally be important. (See *Louis*, *supra*, at 155.)

The ultimate goal of the court is to balance these differing factual contentions and, along with all the remaining statutory equitable distribution factors, fashion an overall distribution that is fair. Judge Havey made this very point when he noted that:

> Hypothetical taxes, presumably fixed by competent expert testimony, is a factor to be considered with all other factors, such as the respective earning capacity of the parties, their health, education and contribution to the marriage, in determining the distributive share of each party. (See *Louis*, *supra*, 8 *New Jersey Family Lawyer* at 157.)

Conclusion

This balancing of factors, which must be accompanied by specific factual findings, should be reflected in the percentage the court awards the recipient spouse. The more likely the tax will be incurred, the lower the percentage the non-recipient spouse should receive. Yet, regardless of the tax impact, there may be other factors the court deems more significant which outweigh what is, in the final analysis, only one of many statutory factors. By carefully considering hypothetical taxes, along with all other relevant considerations, courts not only fulfill their mandate under the statute to divide assets fairly but litigants receive more than mere statutory compliance. Instead, they receive a determination which is reasoned, judicious and firmly rooted in legitimate economic realities. *Orgler*, by eliminating arbitrary reductions in equitable distribution values, while requiring, in context, consideration of theoretical taxes, materially advances the primary goal of our Family Court by assuring decisions that are not only equitable, but fundamentally fair. As such, the decision does more than clarify the law — it makes its application more even-handed and just and thus improves the quality of justice administered in family courts of this state. ■

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Chair's Column

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should not pick up the telephone to call the police. One of the important responsibilities of a good family lawyer is to properly educate the client during the initial interview as to the judicious use of this remedy.

The final "truth" learned from our experience with domestic violence exposes the true victim of this legislation which is the court system itself. With no additional Superior Court judges and with no additional compensation for locally funded Municipal Court judges, the existing system has assumed a herculean task by absorbing this flood of litigation. For years in this column my predecessors have given the call to arms for more judges with little affect.

Why is domestic violence the culprit? To some degree it is because our Family Court system has dealt with this critical issue so successfully. Domestic violence complaints are afforded the priority that they deserve. They are given serious attention and dealt with immediately. Normal, well-planned court calendars are interrupted two, three and four times every day by domestic violence hearings brought before the court on an emergent basis. As many different systems have been tried to deal with this crisis as there are different vicinages. In virtually every county the end result is the same — we need more judges and staff to deal with this critical issue. The final analysis is simple: if domestic violence takes top priority, all other priorities are pushed down a peg. The system simply has not been dealt a fair hand in dealing with the volume of new cases it had to absorb.

At the present time, a specially convened committee is examining a protocol for the use of hearing officers on initial applications. Just as my predecessor, Jim Yudes, explained in some detail in this column last year, I, too, am deeply concerned about the ability of the court to defer constitutional powers to an appointed official who most likely will be a non-lawyer. This concern is heightened by the nature of the relief this officer will be expected to grant which involves a severing of fundamental rights to property and custody. True, some hearing officers may be more sensitized and better educated as to domestic violence issues than some Superior Court judges who rarely handle family matters. Even so, there is no substitute for judicial education, experience and understanding of the fundamental legal principles involved. We still need more Judges.

Just as I have been writing about the evolution of the practice in Family Court in other areas, so too am I optimistic that greater public awareness and years of experience with this domestic violence legislation will begin to have an impact on our society. The socialization process may include an understanding that rights to privacy in family matters do not include the right to conceal abuse. Perhaps this legislation may prove to be the vaccine society needed to fight the battered spouse syndrome and which may eventually lead to a reduction in complaints. The final report card on domestic violence in New Jersey reveals that the system works because of the dedication of the people who run it, and unfortunately at the expense of efficiency in handling other cases before the court. The recommendations of Pathfinders for a general upgrading of Family Court resources, staffing and number of judges (including a statewide floating judge program) offers a glimmer of hope. We just hope that it arrives before the burdens on the system cause it to collapse. ■