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# Marmer Penner Inc. Newsletter

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## Impact of Unreported Income on Business Value: Recent Case Law

In two recently reported cases, the Court made seemingly contrary findings with respect to the impact of unreported income on the value of a business. In *DeBora v. DeBora* [96-MP-225420] and *Poirier v. Poirier* [19 R.F.L. ($6^{th}$) 197, [2006] W.D.F.L. 79 [2006] W.D.F.L. 108] the Court had to decide on how unreported income should impact on the valuation of a business interest. Interestingly, these cases dealt with the same issue but had different outcomes.

In *Poirier*, a husband owned 60% of a heavy equipment dealership through a holding company. Evidence adduced at trial showed that significant unreported cash sales were part of the dealership's regular operations. In fact, after the date of separation, the Court heard that the wife continued to receive 50% of the husband's share of the unreported income. Although the wife's valuation expert did not make a specific adjustment for unreported income, the wife's lawyer argued that the business value should reflect (i.e. be increased by) the unreported income.

In the decision, the Court accepted that the company was receiving substantial unreported cash sales, but did *not* accept that such income would increase the value for the company. The Court was not convinced that the unreported cash sales would have had any role in the negotiations between a vendor and purchaser. The Court found that it was unlikely that the vendor would try to prove the existence of unreported cash sales to the purchaser. It is important to note that neither expert attempted to quantify the unreported income or its impact on value. Accordingly, this evidence was not available to the Court. It appears from the decision that the Court did not have a concrete and definitive number upon which to base a judgment. According to Justice Charbonneau: “There is no evidence that [the cash sales] could be independently established and therefore a purchaser would not likely ascribe any weight to them.”

In *DeBora,* the husband owned a global multi-level marketing business that distributed health food products. During the year of separation, the company’s books were subject to audit by the Canada Revenue Agency (“CRA”). The CRA compared shipping documents to sales invoices and found that the number of shipping documents exceeded the number of sales invoices – usually a strong hint that there may be unreported income. When pressed to do so by the CRA, the husband reconciled the shipping documents to the sales invoices and admitted that there was nearly $2 million in unreported income during the year of separation. The expert for the wife assumed that the husband would have demonstrated the extent of unreported sales to a willing purchaser. Accordingly, a valuation adjustment related to the demonstrated unreported sales was made within the expert report submitted on behalf of the wife.

This case differed from *Poirier* given that the Court had a concrete, determinable amount on which to base valuation adjustments. According to Justice Backhouse: "[The] unreported sales was information known to the husband and which would likely have been disclosed to a prospective purchaser to maximize the sale price."

A review of these two cases indicates that it is not enough to merely prove the *existence* of unreported sales in order to have value impacted. It is also necessary to be able to *quantify* the amount of unreported sales that are involved and *calculate the impact* on value in order for the Courts to accept valuation adjustments.