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Divorce and Business Assets: What You Need to Know


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Viewpoint

Divorce can be challenging, stressful, and wrought with emotion. In circumstances where one or both spouses have business interests to protect, it can also be complicated.

Whether you have spent years building your business, or perhaps inherited a family business, you have invested and sacrificed greatly to ensure its success. Chances are you don't want to share the boardroom or management decision-making with your ex-spouse. You also want him or her to only get a fair share of the fruits of your labor.

Here, presented in a Q&A format, is some important information on how to protect yourself and your business partners in the event of divorce.

Q: In a divorce setting, how much of my business is my spouse entitled to, and how is this calculated?

A (Steven Paquette): Dan will describe the way he goes about valuing the asset. Once valued, the parties will negotiate, or a Court decides a number of questions. How much did the titled spouse contribute to the success of the business (vs. work by others or market forces). How much did the non-titled spouse do to make the other available to do that work (caring for children, maintaining a household, etc.)? Did the non-titled spouse do anything without adequate compensation that directly assisted in the growth of the business?

Finally, it will be determined whether any of the value of the business is pre-marital (existing at the time of marriage), or non-marital (a gift or inheritance to the title spouse alone). If so, the non-titled spouses share will be limited to increases in value after the date of marriage or the date the gift or inheritance was received. If not, a percentage (typically 20 percent to 40 percent, but each case is different) of the full value established by Dan will be assigned to the non-titled spouse.

A (Daniel Griffin): Steve touched on how much of a specific asset (typically 20 percent to 40 percent) he/she is entitled to, which I'll label as the indirect piece of equitable distribution. Before you can determine that dollar amount, you'll have to know the direct price, which is the value of the asset itself. Certain assets are easier to value than others (i.e., it's easier to value shares of a company that are traded on a public exchange versus shares of a closely held company, the same as it's easier to value $100,000 in cash vs. a house that was purchased for $100,000 some 30 years ago).

Specifically referring to closely held businesses, the spouse will normally hire a valuation expert to provide an estimate of value. Using the commonly accepted methods (being the income, asset, and/or market methods), and a variety of assumptions that are chosen by professional judgment and specific facts of the company, the valuator will determine the fair market value of the asset in question. From there, the indirect piece is applied. However, what may complicate things is the other spouse may have his/her own valuation expert, and the two experts may come up with estimates of value that are significantly different.

Q: Can my ex-spouse make me sell my business?

A (SP): A judgment after trial, in which a Supreme Court justice decides the parties' respective interests in the assets, leaves open that possibility. If you are directed to pay a sum to compensate your spouse for his/her investment of time into the business, and do not or cannot do so by a court-imposed deadline, the remedy may be a forced sale of your interest, or a liquidation of the asset to pay the ex-spouse. However, judges do not want that to be the outcome, so it is a rare event.

A (DG): As Steve said, this is a rare event, but that's not to say it can't happen. Similar to the example I gave above, if the circumstances are right and the business-owner spouse doesn't have liquid assets available to monetize the other spouse's share, a judge could mandate that the business (or part of the business) be liquidated and the cash distributed to the non-owner spouse.

Q: Can my ex-spouse one day sit next to me at the boardroom table?

A (SP): That should never happen if you have done your homework. The non-titled spouse has an interest in the value of your business in many instances, based on the notion that he or she contributed directly and was not compensated for that contribution, and/or "indirectly" to the business' success by allowing you the time and opportunity to dedicate yourself to the business while the spouse attended to things that would otherwise be done by you. But well-drafted corporate documents restricting transfer, and fixing value at the time of a sale of an interest, and a carefully negotiated settlement agreement should prevent direct ownership and favor compensation through other existing assets or a payout over time with interest.

A (DG): While this is more of a legal question, the answer does depend on the dollar figures, as well as what restrictions and agreements are in place before the divorce happens. This is definitely something that, in most cases, none of the parties desire to be the outcome, and that includes the husband or wife's business partners who also have to sit at the (now, more awkward) boardroom table. An example that might lead to this would be if a husband's shares of a closely held company are worth $2 million, and it's been determined that the wife is entitled to one-half. If the husband does not have the ability and the liquid assets to reimburse the wife for the $1 million she's entitled to, and there were no restrictions or agreements in place that Steve touched on, the wife may have to "step in" to owning those shares, if no other payout can be negotiated or ordered by the court.

Q: What if the business was handed down from my family members to me?

A (SP): That is the "gift or inheritance piece" mentioned above. There, Dan will have to do more work, establishing values at the date of gift or inheritance, and determining if there has been appreciation in the value of the asset since that time. Thereafter, the same questions are asked on direct and indirect contribution.

A (DG): As Steve described, if some or all of a business is gifted or inherited, depending on the timing of the gift/inheritance, this will be separate property. However, the question will be whether or not the value appreciated over the length of the marriage, thus becoming marital property. In order to be able to estimate appreciation, the valuator would in essence have to perform two separate valuations for two different points in time. This is why it's important for companies to maintain accurate sets of books and records throughout time.

Q: What if I owned my interest prior to the marriage?

A (SP): In that case, Dan would establish a value as of date of marriage, and continue the same analysis as set forth above for a gift or inheritance.

A (DG): Along the same lines as if an interest was gifted or inherited, the issue here would be whether or not any appreciation occurred, which would require estimating value at the marriage date and the divorce date. What could save the couple (and/or the business) on valuation fees is if there were historical estimates of value available, and if any of those were around the same time of the marriage. Historical valuations usually would be on file for any buyouts that might have happened, admitting new shareholders, gifting, death, or other reasons. We see some businesses asking for annual or bi-annual calculations of value so that the owners have a sense of what their business is worth, as well as having value documented just in case it's needed later on.

Q: Does it help or hurt if my spouse has been paid a salary?

A (SP): If he or she was paid a salary, it is a direct contribution (the work performed for which pay was given), and will be considered separately from the determination of indirect contribution. For example, if the spouse was paid for work as a bookkeeper, then he/she could not claim that he/she was entitled to an ownership interest as a bookkeeper since compensation has already been paid. But if your spouse also joined you at trade shows on the weekend, or cared for the children while you were out of town, then that would be an indirect contribution to be considered in a valuation.

A (DG): We would consider the spouse receiving a salary from a few different perspectives. As Steve touched on, first if the spouse worked in the business, we'd look into whether or not he/she had something to do with appreciation of the business, and would then have to determine what role he or she played in that.

However, we'd also look at salary from a value perspective in order to decide whether or not we'd need to adjust the company's income stream when preforming the income method to determine value. An example would be if a wife owned 100 percent of a business and paid her husband a $250,000 salary for little-to-no responsibility, we'd have to adjust the payroll expense to reflect fair market-value compensation based on what duties he was actually performing. And the last thing we would look to do is make sure that whatever adjustment we make on the asset (value of the business) side, we stay consistent on the maintenance/alimony/child-support side, so that the profits already accounted for, being paid out for the business-owner's share of profits, would not be counted twice in maintenance calculations.

Q: What about my business partners? Can I get drawn into their divorce(s)? What steps can I take in advance to try to protect my assets, and my partners?

A (SP): Properly drafted corporate or business documents should insulate you from that. Additionally, the safest course of action is for you and your business partners to consider prenuptial agreements or postnuptial agreements that quantify a spouse's benefit ahead of time, and limit the risks as well.

A (DG): As Steve states, there are a variety of ways you can go about protecting your business as well as the key employees and owners involved. Every business is different and has its own specific set of needs and issues, so proper planning should take place. What's an interesting option is to use the collaborative divorce model in a business setting — to sit down with your partners (before any of these issues come up) and brainstorm, plan, and collaborate to get agreements drafted that will best protect you. ■

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