

Protecting Your Business Assets During Divorce

by Barbara E. Keon, Esq.

More than 50 percent of marriages end in divorce. Most of us are aware of this sobering statistic and the looming vulnerability it presents. Many involved in divorce lose their homes, their family life, and a large part of their personal assets. But did you know that divorce can also mean the end of your business as you know it?

Tales abound of very smart business owners who, suffering either from love or lack of awareness, have failed to protect their business assets from potential claims in divorce court. One way to avoid future legal skirmishes is to be proactive before the fact with a prenuptial agreement. After the fact, if the marital knot begins to unravel, arm yourself with aggressive legal counsel and educate yourself on Georgia law and its potential implications.

Equitable Doesn't Mean Equal

An important aspect of our state's divorce law is that Georgia is an equitable division state, not a community property state. Spouses can divide assets in any manner they think fair. It does not necessarily have to be an equal division because "equitable" is not synonymous with "equal." When spouses agree to disagree, a court decides who gets what. The court considers factors such as length of marriage, contributions of the parties to the marriage, age, educational level and health of the parties, and causes for the dissolution of the marriage.

It surprises many people to learn that businesses and partnerships are among the assets subject to division. That closely-held company you've spent 20 years building or that service-oriented partnership you've worked 18-hour days developing has value, and that value is part of the marital pie. Awareness and planning are keys to protecting these assets from divorce court.

Prenuptial Agreements

Prenuptial agreements are enforceable contracts that could limit or preclude a prospective spouse's claim to the business and personal assets brought into a marriage. The enforceability of prenuptial agreements hinges on their having been voluntarily entered into with full disclosure of assets and income.

Separate property — assets brought into the marriage, or assets inherited or gifted during the marriage — is not subject to equitable distribution upon divorce. However, spouses often make claims to this separate property when it has become co-mingled or jointly titled, has appreciated in value during the marriage, or when it was subsidized through income earned during the marriage. Separate property can also be considered by the court in

awards of lump sum alimony or as income from which spousal support can be paid.

All of these anticipated events can be addressed in advance of marriage, and if the prenuptial agreement is fair at the time of enforcement, Georgia will honor the contract. So before you plan the honeymoon, plan to protect your business interests and other separate assets.

Valuation And Goodwill

If you are already married and you own a small business which is not publicly traded and was in operation during the marriage, your spouse will probably make a claim to this business upon divorce. The real issue is defining the value of the business. A qualified appraiser can determine value using five years' worth of tax returns and financial statements.

Normally, a conservative value is based on asset or book value. Your spouse will undoubtedly wish to view the business as an investment and look to what someone knowledgeable would pay for its earnings or assets, whichever is greater. It is not uncommon for small business owners to pass "personal" expenses through the company, including cars, retirement plans, country club dues, loans, travel and entertainment, relatives on payroll or the personal use of a boat or plane. Typically, the estranged spouse will try to make adjustments for these perks. On the other hand, the business owner will want to reduce the value of the business through market discounts, liquidity discounts or minority stockholder discounts.

Market discounts refer to a reduction in an asset's value because of a lack of potential buyers. Liquidity discounts reduce the value of an asset because it is difficult to convert the asset into cash. And minority stockholder discounts reduce value because a minority stockholder does not have the power to force a decision. Combining all three of these discounts can dramatically reduce a business' value by as much as 75 percent.

The term "goodwill" refers to the ability of your company to generate cash over and above a normal return on assets. It means you do a better job than your competitors. "Goodwill" can also be called patronage, reputation, location or the uniqueness of a product or service. As you might guess, "goodwill" is a frequent source of acrimony during divorce since it is an intangible that one spouse will try to inflate and the other try to devalue.

Structuring The Deal

Once the business has been appraised and the appropriate percentage of value allocated to the

spouse, you may pay your estranged husband or wife in a number of ways. You might consider offsetting the business with other marital assets such as real estate, stocks, bonds, or cash accounts, thereby keeping your business entirely intact. Another option is to pay your spouse over time with profits from the company and ensure those payments through life insurance. Or, the company might consider a repurchase of the spouse's shares. Keep in mind, of course, that everything is done with after-tax dollars, so the value of the business should be adjusted to reflect taxes to be paid. You might also consider increasing the amount and duration of tax-deductible alimony in lieu of a share of the business.

Professional Practices

If you are a partner in a service firm such as accounting, law or medicine, you can also face similar problems during divorce. While you may view your partnership as an income stream which terminates upon your death and cannot be sold or transferred, your spouse will disagree and try to assign value to your earning capability. He or she will claim it as a marital asset if you acquired your expertise and built-up your practice during the life of the marriage. Your spouse may claim that he or she assumed all responsibility for child care and the home and played the perfect corporate spouse, enabling you to develop your knowledge, experi-

ence and reputation and entitling them to share in this valuable asset. Your spouse may try to quantify the value of your practice through expert testimony using a theory such as "excess earnings." That is, the claim may be made that your skill is better compensated than your peers and results in annual earnings in excess of the family budget or a "normal level" of compensation. When this excess is projected to your future work life expectancy and discounted to present day value using a discount rate to convert the stream of income into value, your earning capability is now a quantifiable asset of the marriage. Short of depressing your income, there is not much that can be done to counter this valuation except to hire the best divorce lawyer you can find to formulate your own position!

During divorce, all assets have a value that can be quantified, and quantifiable assets are subject to equitable distribution. Included in the total valuation are your business or your partnership. They are as much marital assets as your home, your automobile and your retirement plan. So, think ahead before you make the vows and remember to protect your livelihood as you saunter down marriage's sometimes bumpy path.

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