A Family Business Does Not Have to Be a Casualty of Divorce

Divorce is difficult for all parties. But when there's a family business involved, divorce can be a nightmare. Take a look at a couple of common questions:

Should the enterprise be sold? Selling the business makes it easier to allocate the assets owned by the couple. But that solution is not common, since it generally leaves one or both spouses looking for work. Economic reality may force ex-spouses to try to continue working together, although taking that path obviously has problems of its own.

What if a business has two locations? Perhaps each spouse simply take over controls of one company and operates independently. That may seem like an adequate answer, but it's unlikely that the two locations have the same value. After an independent business valuation has been performed and accepted, one spouse will probably need to receive a financial offset to equalize the division of assets.

Probably the most common solution is that one spouse will take over the business, buying out the interest of the other spouse. Again, this requires that the value of the company be established to the satisfaction of both parties ... and this is where complications frequently arise.

Conflicting Interests

Obviously the buyer-spouse wants the value of the business to be set low and the seller-spouse wants the value set high. Each spouse can hire their own expert witness to determine the value of the business and end up with two vastly different dollar figures, each reflecting the interests of their clients.

What happens then?

The courts can step in and decide how much the business (or business interest) is worth. In most states, the appropriate standard of value in divorces cases in "fair value." The definition of this term varies from state to state, but it's often based on the "fair market value" standard that's used for tax purposes, usually with some adjustments.

The overriding principle in divorce cases is fairness. So, divorce courts may not consider tax consequences or allow discounts for lack of marketability or lack of control if they think it would unfairly enrich the buyer-spouse. (Typically, these factors are considered when estimating fair market value.)

Fair market value is defined as the price, in terms of cash or equivalent, that a buyer can reasonably be expected to pay, and a seller could reasonably be expected to accept, if the business were exposed for sale on the open market for a reasonable period of time. In addition, both the buyer and seller should be in possession of the pertinent facts and neither is under any compulsion to act

Another important issue to consider is goodwill, which is the different between the business's value and the combined value of its identifiable assets. In a few states, the entire value of the business — including goodwill — is part of the marital estate. Alternatively, some states exclude all goodwill from the marital estate.

About half the states separate goodwill into two pieces: personal goodwill and business goodwill. The former can't be separated from the business owner. The latter is a function of the business's location, employees, name recognition, contracts and customer lists. These states include entity goodwill in the marital estate, but exclude personal goodwill if maintenance awards are based on the owner's future earnings.

Hire an Expert

Fair market value can be a good starting point for calculating value in divorce cases. But experienced experts know that valuations in a divorce context requirement special considerations. Arguments and adjustments can be made to resolve the specific issues of the case and achieve an equitable distribution of assets.

If you are concerned about, and would like to discuss, how a divorce may affect the value of a family business, please contact Gryphon Valuation Consultants.

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