



Erik Gunn is a magazine writer and editor in Racine, Wisconsin.

Keeping Your Business Together

Incorporation and charting a clear ownership path from the start could help protect your company when a personal partnership ends

By Erik Gunn

When we start a business, we naturally hope that it will succeed and grow. And when we get married, we expect it to last forever.

Social scientists tell us the widely held belief that “half of all marriages end in divorce” is way overstated; there’s even some evidence that divorce rates are falling. But you need only look around — not just at the newspaper headlines, but to your own circle of acquaintances — to see that for many couples, there’s no fairytale ending.

So if divorce happens to you, how can you best manage the outcome where your business is concerned? Scott Downing, a Dallas family law attorney who advises small-business owners, shares his general advice on the matter.

“Courts typically don’t want to keep a true mom-and-pop shop in business together. Usually the situation works out that the court will award one spouse or the other that company.”

Scott Downing

LARGEST ASSET

A family-owned business “can often be the largest asset in somebody’s estate,” says Downing. So if there’s conflict over dividing property in the divorce, it’s likely to be at the forefront.

How it plays out can depend on several questions of fact. Was the business formed before or after the marriage? What sort of business structure surrounds the organization, and has that changed at some point in time? And how do the laws of your state treat the property of either spouse or of the couple?

In many states, “ownership” is based on a long-standing principle of common law: whose name is on the deed, title or other property registration document. If only one spouse is listed, that spouse is the owner.

Nine states — Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin — have “community property” laws that govern the division of assets and liabilities. In Texas, for instance, both of those are divided “as just and right,” under the law.

TIMING

That’s where the question of timing comes in. In Texas, a business owner who subsequently gets married retains personal ownership of the business in the event of a divorce, Downing says — so long as the basic ownership

structure of the business hasn’t changed.

Generally, if the business was started after the marriage, the interest in the business is subject to division, not necessarily evenly, Downing says. Dividing that ownership then becomes part of the divorce settlement process.

That shouldn’t mean the actual business assets get divided — one gets the service vehicles and the other gets the office and shop. Under a commonly held “entity theory” of business, the married couple owns partnership units or stock in the company. “They don’t actually own the underlying assets,” Downing explains.

That’s just one more reason to go through the steps of incorporating the business startup. Then, Downing says, you should stick with that structure or character: A major change in the structure of a business, if not done right, can vastly complicate the question of who owns it and how it might wind up being divided.

FAMILY AFFAIR

Many small businesses truly are a family affair, which can be both a blessing and a bane. When divorce occurs then, “courts

typically don’t want to keep a true mom-and-pop shop in business together,” Downing points out. “Usually the situation works out that the court will award one spouse or the other that company.” The spouse who gets “custody” of the business may have to pay the other spouse for his or her interest in the firm out of the other assets in the estate.

“That’s where you get into, for example, business valuation,” Downing says. “It’s extremely important for someone who owns a small business to hire an attorney and experts who understand business evaluation.”

Set the value too high and the owner going forward can’t pay for the buyout out of cash flow. “That can be a real danger to the ongoing activities of the business. You’re killing your operating income, the reserves, everything else,” says Downing.

If the court sets the value too low, however, the spouse being bought out “might be walking away with very little compared to the ongoing value of the business.”

Another complication is almost endemic to most small businesses even though it’s against the advice of every professional business adviser out there. “Smaller businesses tend to run a ton of personal expenses through the company,” says Downing.

That makes it harder to disentangle the finances of the marriage from the finances of the business, which “is really probably the livelihood for the

marriage,” he says. It may also complicate the question of who actually owns it as an asset to be divided in the divorce.

COMPETITIVE THREAT

In some cases, both spouses fight over rights to keep the business. That could lead to a court ruling awarding the business to one or the other party. Whoever wins that fight and gets the business “needs to have a game plan coming into that,” Downing says — especially if he or she hasn’t been as involved in running the company as the other spouse.

And nothing stops the loser in the battle from setting up a competing business, he points out. For the “winner” who was less involved, the victory could be hollow, especially if a big part of the value in the business grew out of the “loser’s” goodwill: a network of contacts, customers, suppliers and industry knowledge that can be leveraged into a new, competing company.

If you maintain control of the business after divorce, however, don’t expect to be able to impose a noncompete clause, Downing says. Within reason, courts don’t want to interfere with the spouse’s ability to make a living after the breakup.

On the other hand, if the couple comes to a negotiated settlement about distributing their assets, it’s easier to put a noncompete restriction in place. “If you do a settlement, everything’s on the table that is not prohibited by law.”

ADVANCE AGREEMENTS

The potential for problems raises another question: Should a business owner who marries get a prenuptial agreement?

Theory might say “yes,” but in the end, Downing points out, theory and reality don’t always see eye to eye.

“A prenuptial agreement is so personal it’s almost on a case-by-case basis,” he says. “Some people refuse to sign them. You can insist on a prenuptial agreement, but you might lose your future husband or bride over it.”

Instead, the more practical course of action is to make sure the business is properly incorporated, that the ownership structure of the stock is clean and clear, and that you have an accurate and reliable valuation of the firm. **C**

What you learn on these pages could be worth

\$1,000s

It’s all yours for **FREE!** Subscribe/Renew today.

www.cleaner.com 800/257-7222