

Cathy C. Hunt



Divorce and your business

Answers to common questions about its impact.

I have to pay alimony to him?

Women are the breadwinners in more and more families today. Because of their many obligations and the imbalance of power that comes with being the primary wage earner, some husbands fall to the wayside. For example, Kim became a partner in a law firm while her husband pursued a career as a developer. His projects never quite came through or generated much profit. When Kim and her husband separated, she was indignant that she had to pay him alimony when she had worked so hard for her position in life and viewed his career as little more than a hobby. Men are more accustomed to the idea of paying alimony. In my experience, it is a bitter pill for women to swallow, but it is becoming more common.

What are the tax implications of alimony and child support?

Alimony is based on the accustomed standard of living during a marriage. It is often calculated from 24 months of bank and credit-card statements. The financially dependent spouse's income is compared with his or her monthly expenses. Any shortfall is made up with alimony to the extent that the financially supporting spouse has the ability to pay. Alimony is taxable to the recipient and deductible to the payor. If the dependent spouse has a shortfall of \$3,000 per month, that amount has to be "grossed up" for taxes so that the net is \$3,000. For the payor spouse, the amount paid is an above-the-line deduction on his or her taxes. If he or she pays

\$75,000 per year in alimony, that amount is not subject to fees or state income tax. While the annualized deduction may be beneficial, the grossed-up number often compromises monthly cash flow, at least during the first year, before the deduction is realized. In some cases, parties agree that support will not be taxable to the recipient or deductible by the payor. This scenario is sometimes referred to as family support, and it makes more sense when the same amount of money now must support two households. Child support is neither deductible to the payor nor taxable to the recipient.

How is a business owner's income calculated for alimony or child support?

The true monthly take-home income of a business owner has to be calculated to exclude phantom income. That appears when income from a partnership, S Corp or limited liability company flows to a personal tax return, making a business

was taxable income of \$1 million per year, the cash either remained in the company or he received just enough to pay taxes. The court did not understand this concept and commented, "I don't know why his tax return is any different than mine." The court in that case awarded the wife \$25,000 per month in alimony. It is important that your legal team retains an accountant who is experienced in calculating net after-tax cash flow in divorce cases and is an experienced testifying expert who can explain phantom income to the court in a way that it is easy to understand. An independent third-party expert also lends credibility to how much the owner actually takes home.

I have been using my work email and phone to communicate with a romantic interest. Can that information be obtained by my spouse in a divorce?

Yes, if either spouse has filed a lawsuit, both parties' lawyers can issue discovery requests requiring parties to produce emails, text messages and phone records. An employer also may

The true monthly take-home income of a business owner has to be calculated to exclude phantom income.

owner's income appear to be more than he really receives. In a recent case, a member of an LLC was being sued by his wife for alimony. Her lawyer waved the husband's tax return around, proclaiming that he made \$1 million a year. Although there

be subpoenaed to preserve and produce emails, texts and phone records. A spouse who receives such requests for email or phone records could file a written objection, claiming that the request seeks privileged or protected

information or is otherwise unreasonable and burdensome. However, a court will likely order the objecting spouse or his or her company to produce the information. If you don't want your company dragged into your divorce, don't use work communications for nonwork purposes.

Ownership contracts should have a provision that lists the value at which the shares will be repurchased in the event of an owner's separation or divorce.

My spouse and I own a business together. Who will get the business if we divorce?

A business that is owned by both parties and created during their marriage is marital property and subject to distribution pursuant to divorce. In essence, the business is treated like any property owned by the couple. The parties can decide who gets the business. If they can't, the court will likely award the business to the spouse who is more involved or capable of running it. In that case, the business must be valued and the retaining spouse will pay the departing spouse for his or her interest in the company. That payment may be in cash, either a lump sum or over a period of time, or may be offset by other marital assets.

How can business owners protect their business from a business partner's divorce or their own?

The best way to protect your interest in a business from your spouse or the spouse of your business partner is to avoid issuing any ownership in a spouse's name if they are not involved in the business. If you are attempting to shield your interest from your spouse, you should maintain control of your business from the beginning. This can be done in a number of different contracts such as premarital agreements,

post-marital agreements, buy-sell agreements, operating agreements or shareholder agreements. Any of these should include a provision that states in the event of divorce shares or ownership interests of the spouse no longer involved in the business must be sold back to the business according to a formula such as book value.

Alice, my client, was a 49% shareholder in a business she owned with her husband. When there was a domestic dispute, the company came to a complete standstill, because the shareholder agreement did not have a provision on what would happen in the event of a separation or divorce. The parties spent hundreds of thousands of dollars in court trying to gain control of the assets. Meanwhile the company was in complete deadlock. Ownership contracts should have a buyback provision that lists the value at which shares will be repurchased in the event of separation or divorce and gives the company the right, but not the obligation, to repurchase the shares. This will protect the business owner in his own divorce or from the spouse of a divorcing business partner.

How will my business be valued in divorce?

Competent divorce lawyers skilled in business valuation issues and competent business appraisers are not inexpensive. Hiring a CPA or economist who does not have business valuation and litigation training and experience may save you money at the start, but his or her value may ultimately cost you thousands of dollars or more in the end if their valuation is shredded in cross-examination and rejected by the court. The old adage "you get what you pay for" applies here, and divorcing business owners must be careful not to compromise their entire case by hiring either inexperienced counsel or appraisers. An inaccurate business appraisal is not only detrimental to the divorcing spouse, but the business and other owners also will feel its impact. This occurs because the incorrect value will serve as a precedent in negotiations over the sale of the company, the buyback of an owner's shares or in the valuation of another owner's interest if he or she gets divorced. All of these costly mistakes can be prevented. Having the right team of legal and financial advisers experienced in business valuation and complex financial cases is the best protection against the far-reaching effects of having a business incorrectly valued in a divorce case.

CATHY C. HUNT is a senior partner with Gailor, Hunt, Jenkins, Davis and Taylor PLLC. She dedicates her practice to the representation of high net worth business owners going through divorce. Formerly, she practiced corporate law with Womble, Carlyle, Sandridge and Rice in North Carolina and McGuire, Woods, Battle and Booth in northern Virginia. Her corporate-law experience provides her with the expertise that is necessary to understand complex equitable-distribution cases, especially those involving business-valuation issues. She has written for numerous business publications on issues related to the impact of divorce on businesses and business owners. She has been recognized by her peers as a member of *BUSINESS NORTH CAROLINA*'s Legal Elite in family law. She also has been named as one of North Carolina's Top Lawyers in family law.