

Marriage, Divorce & The Family Business: Is What Is Mine Really Yours Too?

Written By **William S. Durr** (wsd@wardandsmith.com)

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North Carolina's equitable distribution laws provide the framework for determining how property will be valued and divided when one or both partners in a marriage decide to separate.

Before doing a deeper dive into how one's ownership in a closely held business (often a family business) may be affected by a separation or divorce, let's take a moment to review North Carolina's equitable distribution laws.

Equitable distribution in North Carolina consists of a three-step process: 1. Classification, 2. Valuation, and 3. Distribution.

Classification

Initially, the Court (or the parties' respective attorneys) must determine what property might be subject to distribution. Property is a very broad term. It consists of real (for example, land, houses, commercial property) and personal property (for example, bank, investment, and retirement accounts, separately held stock, and LLC membership interests). In most instances, only property owned on the date of separation is classified.

North Carolina law establishes three "categories" of property:

1. **"Marital property"** means all real and personal property acquired by either spouse or both spouses during the marriage and before the date of separation. Marital property includes, but is not limited to, ownership interests in businesses, stock, and retirement accounts.
2. **"Divisible property"** means all passive appreciation and depreciation in marital property and all passive income from marital property after the date of separation and prior to the date of distribution. Divisible property also includes property received after the date of separation and before the date of distribution that was acquired as a result of the efforts of either or both spouses during the marriage and before the separation.
3. **"Separate property"** means all real and personal property acquired by a spouse before the marriage or acquired by gift or inheritance during the marriage.

Valuation

The critical valuation analysis is determining the net value of the marital and divisible property. Only marital and divisible property may be distributed between spouses. As a general rule, marital and divisible property are divided equally between the two spouses unless the Court determines that an equal division is not equitable. If there is a contention that equal is not equitable, then the value of each party's separate property is relevant for this analysis – more on this in a future article.

Distribution

The final step in the equitable distribution journey is distribution. In the context of a negotiated settlement, how marital and divisible property is divided is often the "art" of this process. All too frequently, both sides "want" the former marital residence, the 1968 Camaro, and the collection of German beer steins – you get the idea. However, if it were possible to remove the emotion from this equation (which is a pipe dream), then two disinterested individuals probably could divide up the marital and divisible property without too much disagreement. If the division of the "stuff" results in one party receiving more value than the other, then the equalizing step is what is known as a distributive award. This is essentially a cash payment to equalize the value each spouse receives.

How will separation or divorce impact the family business?

Separation and divorce carry with them an emotional toll, not just for the spouses, and their children (if any), but if one of the parties has an ownership interest in a closely held (family) business, it will impact business operations as well. First and foremost, if during the marriage, a spouse acquires an interest in a closely held business and that acquisition does not come about by gift or inheritance, the interest will be classified as marital property, and the interest will have to be valued. The valuation process often requires one or both parties to retain a business valuation expert. In order for the expert to perform their analysis, it is likely the business will need to produce a significant amount of financial and other data. In many situations, the business will be joined as a party to the lawsuit between the spouses. Once the business is a party to the lawsuit, it might need its own attorney - separate from the attorney for the spouse with the ownership interest. Finally, if the ownership interest is a marital asset, then a Court could distribute the ownership interest to both spouses or, conceivably, to the spouse who previously had little or no involvement in the business. Even if the Court distributes the ownership interest to the spouse involved in the day-to-day operations of the business, this distribution could result in a significant distributive award to the non-business owner spouse, creating a significant cash flow problem for the business owner spouse.

By way of example, let's assume the parties own a house with a net value of \$500,000, bank and investment accounts totaling \$300,000, and the family business started and operated by the Wife during the marriage has a value of \$2,000,000. If the Court distributes the house and bank/investment accounts to Husband and the business to Wife, the Wife will not receive any liquid assets but will owe Husband \$600,000.00 as a distributive award. While the Court can order this paid over time, it nevertheless creates a cash flow issue for Wife.

This example is fairly straightforward. The analysis becomes far more complex if the Wife in the example above acquired her ownership interest in the family business – started by her grandfather – through gifts made to her by her parents, but she worked in the business and was the driving force behind the family business's growth throughout the marriage. Let's complicate it even further – the Husband also worked in the Wife's family business and is very familiar with the business operations. Could the Court distribute to Husband an ownership interest in the business?? It is possible...

Proactive Steps to Protect the Family Business

There are several steps one might consider in order to avoid such a result and possibly avoid some of the angst the business will endure during the equitable distribution process.

A premarital agreement is an option. Of course, this requires forethought or a business owner who insists that any family member has an ownership interest in the business, or who might acquire a future interest, enter into a premarital agreement. This is far more common than one might expect. We will explore this option in greater detail in a future article.

A post-marital agreement also is an option. For example, prior to gifting an ownership interest to a child or grandchild, one might require the married recipient of the gift to execute a post-marital agreement with the recipient's spouse.

A third option, which can be combined with either of the first two options, might be the modification of the business's governing documents so as to specify who may hold an ownership interest in the business, as well as certain buy-out provisions in the event of separation or divorce. However, if one utilizes only the third option, it does not eliminate consideration of the value of the spouse's ownership interest in the business as a part of the equitable distribution process.

In summary, it is important to understand that unless additional steps are taken, generally before the marriage, a thriving family business may experience unintended consequences, often to the detriment of the business and its owners.

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