

How divorce can destroy your business



Emily Ross Tuesday, 01 December 2009

Divorce is a very expensive business. Ask John Cleese. The 70-year-old actor is facing a hefty divorce settlement after 17 years of marriage (no kids) to Alyce Faye Eichelberger. Cleese must pay his ex \$US19.7 million, around \$US13 million in cash and assets, as well as \$US987,000 per year for the next seven years.

His recent world comedy tour was called "How to Finance Your Divorce" for obvious reasons. In the show he describes his wife as the love child of Bernie Madoff and Heather Mills. Ouch.

Australia is currently witnessing the most expensive divorce in its legal history. The running total of legal fees is \$11 million and the case, being heard in the Family Court of Australia in Adelaide, is far from over.

The couple, who can't be named because the matter is before the Family Court of Australia, divorced after 30 years together. The judge Paul Cronin has ordered that they share the property where their successful agricultural business is based in rural New South Wales, with the court even drawing a map of who gets which area of the large home.

She contends the asset pool up for grabs is much bigger than the \$80 million that he says they have. She is prepared to fund investigations to back her case, hiring forensic accountants both locally and offshore, as well as footing the bill for costs such as 50 overseas witnesses flown to Adelaide to be interviewed for the case.

Only around 5% of Australian divorces end up in a trial at the Family Court and you can see why. This Adelaide case paints a frightening picture of the cost of divorce.

For business owners in partnership with their spouse, divorce can be financial suicide. "There is a lot to lose," says Dun & Bradstreet's Australia and New Zealand chief executive Christine Christian.

Typical patterns for SME owners going through divorce include owners incurring more personal debt, there is a distraction factor, the number of days a business takes to meet its obligations starts to deteriorate and there can be cashflow problems.

Throughout the marriage it is common for both partners to apply for credit jointly. This is where significant risk lies after the split.

Christian says it is vital to extricate yourself from the business (ie. resign as a partner or director of the business) as quickly as possible, if you are no longer working day-to-day in the business - especially if the split is acrimonious.

"They need to relinquish their shares and transfer their ownership if they do not want to take the risk of being liable for any debts that may occur in the intervening period when anything can happen," she says.

"Without any control of the day-to-day activities, you are putting your future financial situation in the hands of a former partner. You have no say, no means to ensure the business is being run the way you want it to be run."

Australia operates on a negative credit reporting system (ie. only the black marks are kept on record), which means if the business stops paying its bills on time and meeting its obligations, the other spouse is tarred with the same brush.

That means not being able to get credit, and in severe cases, not being able to be a company director either.

"The most important thing if the marriage does start to break down is to get some measures in place so that the business can continue to run so that you are not eroding the value of the business," says Christian.

Australian divorce law works under a no-fault system with the same rules and asset tests used whether the asset pool is \$5,000 or \$5 billion. Family lawyer, partner at Septimus Jones & Lee Kate Mitchell says that it is commonly assumed by business owners that the business is "theirs" rather than a shared asset in a long-term marriage.

"Even if the other spouse has no involvement in the business, the business under the current law is still likely to be treated as an asset of the marriage to be divided between the spouses," she says.

According to Mitchell, it is a common misconception that assets will be divided equally or 60/40 in the wife's favour regardless of circumstances.

"Rather the split will depend upon the length of the marriage, whether there are children, the size of the asset pool, what each spouse contributed to it and what each of the spouses' current and future needs are," she says.

Leading family lawyer Michael Taussig, QC, partner at Taussig Cherrie & Associates handles divorce cases for some of Australia's wealthiest families and leading business owners.

In Taussig's experience, the biggest mistake that small business owners make when going through divorce is failing to face up to the fact that the value of the business must be taken into account in achieving settlement.

Not every divorce is complex. Relationships Australia estimates that around half of the couples that divorce in Australia each year, do so without an [expensive] day in court. Divorces can cost as little as \$2,000, with many documents able to be filed online at the Commonwealth Courts portal www.comcourts.gov.au.

If a divorcing couple agrees to a settlement that includes the spouses' obligations and entitlements, divorce can be relatively straightforward. When a case becomes more complex and there are disputes over the value of total assets, family trusts and conflict over inheritance, and/or assets brought into the marriage, fees really start to jump.

Costs including barristers and experts start to climb above \$50,000. From there, the equation 'how long is a piece of string' can come into effect. Those who do decide to let a judge make the final call wait typically 90 weeks for their day in the Family Court of Australia.

The desire to protect a business (and all manner of other assets such as inheritance, wealth before marriage, etc) from divorce is common practice. In order to safeguard a business from divorce, the single most important thing to do, according to Mitchell, is to have a written Financial Agreement between the spouses that has been drafted in accordance with the Family Law Act.

"For instance, it could be specified in the agreement that the business owner is to retain the business, free of any claim by his or her spouse," says Mitchell.

If agreed by both parties, a Prenuptial Agreement before marriage, or a Financial Agreement under section 90C of the Family Law Act during the marriage can see the business "quarantined from division between the parties", says Taussig.

Another legal strategy is to establish trusts and corporate trustees, however this approach is not watertight.

"The Family Court now has power over companies and trusts in many circumstances," says Mitchell. "If the spouse seeking to protect the business is deemed to have effective control of the trust and therefore the business, then it is likely that the business will form part of the assets of the marriage to be divided between the spouses."

Michael Taussig says it is "unusual" for hardworking entrepreneurs to feel cheated in a divorce settlement. "They are usually realistic enough to understand that they must share their wealth."

Divorce FYIs:

- * Assets are valued at the date of settlement or the court hearing, NOT the date of separation.
- * Even if a business is found to have no value, it will be taken into account as a financial resource available to the relevant spouse if it provides a good income stream.
- * Spouses that have given up work to care for children may in fact have to work again after divorce if that spouse's share of the assets upon settlement are not sufficient to support him or her. The other spouse may not be forced to provide additional periodic support (aside from child support) if the non-working spouse has the capacity to obtain appropriate gainful employment.

Source: Septimus Jones & Lee www.SJL.com.au

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