



THOUGHTS ON START-UP COMPANIES IN DIVORCE SETTLEMENTS

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Intro

Start-up companies require considerable thought in divorce settlements. Some reasons:

1. Some will go great guns and become quite valuable.
2. Others will fizzle and flop.
3. And, since we do not have crystal balls, it is often impossible to know how a particular new company will fare.
4. A considerable investment of time and/or finances may have been made during marriage, by one or both parties.
5. Experience a party has had during marriage may equip him/her with a set of skills & and/or specialized knowledge that will be advantageously brought to bear on the new enterprise.
6. Some start-ups have projections – often required to obtain financing – while many do not.

Methods for Handling in a Divorce Settlement

Postema Equitable Award Approach

If a considerable amount of funds has been expended in preparing the launch of the new enterprise, repaying the non-owner spouse half the amount spent may be satisfactory in some instances.

- This is somewhat akin to the *Postema*¹ reimbursement approach to establishing an equitable award for a spouse who made sacrifices, efforts, and contributions to enable the other to attain an advanced degree and certifications, as the case may be.
- As with a *Postema* award, however, it is appropriate to consider non-financial sacrifices, efforts, and contributions made by a spouse to the establishment of the other's start-up business.

“Structured Settlement”

- Provide for the owner spouse to receive an agreed on reasonable compensation for his/her efforts.
- Then pay a portion of what the company earns after paying the compensation – that is, profit - to the non-owner spouse, usually, on a declining scale basis.
- For example – 50% in the first 2 years, then 40% for a year or two, then 30% for a year.
- The declining scale takes into account that, as time goes by, less of the profit is attributable to the marriage and more to post-divorce efforts.

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Defer the Valuation

On rare occasions, it may be best to provide that the business value will be determined at a set time after the divorce.

- This approach provides the valuable benefit of hindsight.
- But, it is not often used because (1) it leaves a part of the settlement unresolved and (2) it will be problematic to determine the portion of the value attributable to post-divorce efforts.
- Another negative is that it often involves the non-owner spouse “looking over the shoulder” of his/her ex to ensure everything is on the up and up.
- But, in some instances – particularly where there is sufficient trust and/or the lack of ability to manipulate operating results – it may be a good fit.

Case Specific Approach

As the above indicates, it is clear that – like so many aspects of divorce - dealing with a start-up company in divorce is a case-specific proposition.

All relevant circumstances should be considered in fashioning an appropriate provision in the settlement.

About the Author

Joe Cunningham has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy, though his practice is statewide.

Endnote

- 1 *Postema v Postema*, 189 Mich App 89; 471 NW 912 (1991).

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