

Newsletter March 2008

## Divorce in family businesses

**DIVORCE IS A REALITY** of life. Statistics New Zealand reported 9,972 divorces in 2005, of which 2,498 were from the Auckland region alone. Those statistics (the latest available) identified the average divorce age for men as 43.3 and for women 40.8.

Divorce with its family issues, social pressures and financial stress, can adversely affect the small and medium sized businesses that families own. That's a significant number in this country.

Divorce isn't a scenario that married couples plan for. However, if owners understand some of the tensions of a separation, they may manage them better and avoid reducing the business' chance of survival.

Divorce tensions can also affect entities jointly owned by unrelated families, where one of those families experiences divorce proceedings.

Some of the issues to work through are;

### The impact on business

While divorce is personal, in a small to medium sized business there is limited separation between personal and business matters. The owners need to have a clear focus. Short term distractions can be manageable but a loss of business focus can be terminal. A typical divorce will have a two-year pressure point; six months before the couple separates and eighteen months after are usually the times of most intense pressure and acrimony. Without a highly disciplined approach, the business will inevitably suffer.

If both the husband and wife work in the business, staff can sometimes feel they're trapped on a battlefield. Here are some ways to reduce the impact;

1. Have strong systems in place to ensure that the business is less dependent on any one person, especially the owner(s);
2. Have a manager who can manage most decision-making, or alternately a board that can act as a buffer between parties
3. Agree that one party steps out of the business should the divorce turn bitter.

Work on separating the business from the personal and focus on each in its own time.

### Avoid freezing the business

In the typical family company, both husband and wife are often equal shareholders, with equal profits, assets and decision-making. When equally entitled shareholders dispute, decisions can often be emotional rather than business-like. One party can veto everything.

The business can't action major decisions, borrow funds, enter into new contracts or be sold. It may not even be able to approve its financial statements.

Ways to avoid these situations include having different ratio shareholdings, for example 51/49 instead of 50/50, or a shareholders' agreement that helps overcome personal disputes between the shareholders.



When the conflict begins, few divorces are relaxed. Emotions can range from indifference to contempt. Too often we see couples causing as much disruption and harm as possible to the other party, rather than achieving a reasonable settlement. If this position escalates it becomes 'lawyers at ten paces,' and everyone loses.

It is extremely important to put commercial pragmatism above emotions. If you declare war then there will be casualties and costs for both sides. The objective should be a commercial settlement so that you can get on with business and life and continue to profit.

### **Financial impact**

A divorce or separation involving a property settlement will have a financial impact that will include;

1. the cost to the business in managing the separation;
2. funding the exiting shareholder;
3. consequential impact of the settlement process

Typically, it is necessary to value the business assets. This normally requires an independent business valuer (possibly an accountant) to thoroughly review the business and financial statements. This will involve inspection by outside parties. In some cases people try to resist an external party's inspection. This is rarely successful. Ultimately the court will require that the business be valued and all records made available.

For the company this means that a substantial amount of administrative time to compile and analyse information adds to the cost. So, the faster and more open the process, the faster you reach a conclusion.

Once values are agreed and a property settlement is reached or determined by the court, it is then a matter of funding the exiting shareholders. In the typical 'mum and dad' company there is not always a huge surplus of liquid assets to achieve this. It is often difficult to sell down assets to a level where it is possible to pay out one of the shareholders or partners.

This may require a substantial increase in borrowings often at a time when the business is least able to secure additional funding. In many family businesses the borrowings are supported by the private assets of the owners. If the property settlement results in one party taking the family home and the other taking the business assets, the remaining owner may need additional funding without the family home to support the borrowing. This may cause funding problems.

### **Other costs**

Apart from the property settlement, you will incur legal and accounting costs. These will vary depending on the assets, the degree of dispute between the parties and the time taken to finalise the matter. Typically, legal costs can range from \$10,000 to \$100,000. The bigger the gun fight, the more expensive it becomes. In any dispute it makes sense to engage professional advisors to help resolve issues, remembering that the more you want to fight the higher the cost.

### **Summary**

The cost and impact to your business will depend on how you and your ex-partner approach the challenges. A review and proper planning can save a lot of pain if this unfortunate situation eventuates. Your advisor can assist with an objective appraisal to help protect your business.

## Changes to Company Tax

Company tax will reduce to 30% for the 2008-09 tax year. This affects provisional tax calculations and imputation credits.

When calculating provisional tax under the standard option for the 2008-09, instead of multiplying the 2007-08 RIT by 105%, the multiplier will be 95%. If calculating provisional tax using the 2006-07 RIT, the multiplier will be reduced from 110% to 100%.

The IRD is currently updating Provisional Tax Guide (IR289) which will be available soon. If you have any questions, contact your Hayes Knight advisor.

## Applying for an IRD Number

The process for applying for a personal IRD number has changed. Now, applicants must complete an IRD Number application form (IR595) and present it with specified documents to either the AA Driver Licensing Agents or selected NZ Post retailers.

The specified documents include an original document from category A and an original document from category B. Both the original and a photocopy of the documents must be presented. There is no longer a separate form if you are applying for an IRD number for a child.

### Category A

- New Zealand full birth certificate (issued after 1 January 1998)
- New Zealand Passport
- Overseas Passport
- New Zealand emergency travel document
- New Zealand firearm or dealers licence
- New Zealand refugee travel document
- New Zealand certificate of identity
- New Zealand citizenship certificate

### Category B

- New Zealand drivers licence
- New Zealand 18+ card
- New Zealand student photo ID
- A letter confirming registration as a student in NZ
- An "offer of employment" letter from your employer, on company letterhead