How Do You Value A Consulting Business In The Event Of Divorce?

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Dear Ask the Attorney:

I read a previous "Ask the Attorney" article, where the author explained that a business owned during the marriage might be subject to equitable distribution in the event of a divorce. For nearly 20 years, I have owned a business which provides consulting services. Although my business has been lucrative, I don't think anyone would buy it because without me, there is no business. Under these circumstances, would my wife have an equitable distribution interest in my business in the event of a divorce?

S.J.
Our guest blogger is Cimmerian A. Morgan, Esq., an attorney with Einhorn, Barbarito, Frost & Botwinick, PC's matrimonial and family law department. Mr. Morgan has successfully litigated many divorce cases concerning equitable distribution of business interests. He is familiar with the valuation process and the complex body of case law relating to this important facet of matrimonial litigation.

Dear S.J.:

Your question implicates one of the more complex areas of family law in New Jersey. To begin, a basic understanding of business "value" in the context of a divorce is necessary. Many are surprised to learn that the goal of a business valuation in the context of a divorce is not to determine the "fair market value" of the business. Rather, it is "fair value" which is relevant.

"Fair market value" can be defined as the amount at which property would be sold between a willing buyer and a willing seller, each having reasonable knowledge of the relevant facts, and neither being under any compulsion to buy or sell. The "fair market value" method permits discounting of value for

lack of marketability (inability to attract potential buyers) and lack of control (inability to dictate the operations or decisions of the company), otherwise known as minority discounting.

The critical difference between the “fair market value” method and the “fair value” method is that the latter does not discount for lack of marketability or lack of control when valuing a closely held business, such as your consulting company.

In other words, the value that your business may or may not command on the open market is not the ultimate consideration in determining its value in the context of a divorce. The relevant value of your business is its value to the marriage, not to a hypothetical third party buyer.

In order to determine the value of a business to the marriage, forensic accountants can utilize a number of different valuation techniques. Generally, greater weight is given to earnings factors for those companies which sell products or services, whereas greater weight is given to asset values for investment or holding companies. Given that your company provides services, the focus of the valuation would likely be the earnings of your company and the amount of “good will” associated with the company. “Good will” is another important concept in the valuation process, which requires a more in-depth discussion.

In short, your business may have value in the context of a divorce regardless of whether it could be sold to a third party. The amount of its value, if any, would likely be the subject of a valuation by a forensic accountant. It is critically important that any business owner, as well as any spouse of a business owner, retain an attorney who is both familiar with the extensive body of case law related to equitable distribution of business interests and experienced in litigating cases where business valuations are at issue.