Protecting your assets in a divorce

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How does the process work?
Working with a financial expert starts with an engagement letter detailing the scope of the job and how fees will be paid. In addition to valuing your dealership, the expert (working together with your accountant and attorney) can compile your marital balance sheet and income statements, devise settlement alternatives and analyze the tax implications of asset distributions and maintenance payments.

Once retained, the expert will request a list of documents needed to value the dealership, such as the last five years' financial statements and tax returns, fixed asset listings, lease and shareholder agreements, floor plan loan documents, and marketing materials. Your expert also will want to tour your dealership facilities and interview you.

What's a marital asset?
How much of your dealership is included in your marital estate is mainly a function of purchase date, prenuptial agreement and marriage length. State laws controlling the distribution of marital assets in divorce proceedings vary widely. Also considered are the commingling of personal and business assets, capital contributions during marriage and legal precedent.

As a general rule, "marital assets" are those assets acquired during the marriage, excluding, for example, inheritances. This becomes more complicated than it seems, because assets brought into the marriage that are maintained or improved over the course of the marriage may morph into "marital assets."

What's my dealership worth?
Appraisers use three approaches to value a business. The cost approach starts with your balance sheet. Line items are then adjusted to reflect market value, rather than historic cost. Alternatively, the market approach derives your dealership's value from the sales of comparable dealerships. This approach - in particular price-to-earnings multiples - is typically the most meaningful barometer of dealership value. Valuators have access to proprietary transaction databases that provide details of comparable deals.

Finally, the income approach estimates future earnings and discounts them to their net present value. Before applying any valuation approach(es), appraisers adjust earnings for nonrecurring and discretionary items. Common adjustments include related-party transactions, above- or below-market owners' compensation, and personal expenses charged to the business, such as luxury cars, country club dues or sporting events tickets. Adjusting for these quasibusiness deductions can be dicey, however - cavalier handling could land you in hot water with the IRS.

What about goodwill?
Goodwill is a big deal in many divorce cases. It's the value of intangibles, which generally equals the difference between the value derived under the cost approach and the value derived under the market or income approach. A handful of states include all goodwill in the marital estate. Conversely, some exclude all goodwill when divvying up assets.

But more than half of the states split goodwill between business and personal goodwill. In these states, business goodwill (intangible value attributed to location, employees, name recognition, customer lists, and so on, which will outlast an individual's involvement with the business) is included in the marital estate. But personal goodwill (value that can't be separated from the dealer-owner) is specifically excluded.

Personal goodwill is typically associated with service firms. But in some cases, courts have ruled that dealer-owner personal attributes -namely, experience and reputation - contribute significantly to dealership value. Valuing goodwill and splitting it between personal and business goodwill requires appraisal expertise.

What can I expect from an expert?
You'll want to pick your expert shortly after divorce papers have been filed. Beware of potential conflicts of interest, such as an ongoing financial interest in your dealership (which usually disqualifies your auditor, who financially benefits from performing your audit each year) and a history of working with your soon-to-be ex-spouse. (This usually disqualifies the preparer of your joint tax return.)

Having an independent, experienced financial expert is crucial for dealers facing divorce. Do-it-yourself appraisals and other financial calculations - or, worse, leaving them in the hands of a judge - can be recipes for disaster. Contact CBM today to learn more about our business valuation services at 301.986.0600.

John Comunale, CPA is a vice president at CBM and has more than 18 years of public accounting experience, providing businesses and their owners with audit, accounting, tax and consulting services. John serves as chairman of our Automotive Industry Committee. He works with large and complex dealer groups on consolidated financial reporting, taxation, and multistate tax services, and has worked on engagements that represent most manufacturers. He also holds the "Certified for Profit" certification from Reynolds and Reynolds. Contact John at jcomunale@cbmcpa.com or 301.986.0600, ext. 127.