

# FAMILY LAW COUNSELING & LITIGATION INFORMATION

## Hoge Fenton Resources

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- Stop Domestic Violence - How to Get Help

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### LEGAL ARTICLE

## Division of Business During Divorce: What You Need to Know

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The most valuable asset in a divorce is often the community property business. Decisions regarding the business are often complicated by third party interests. Other owners, employees, the business owners and their family all have stakes in ensuring that the business is handled correctly during a divorce. Unfortunately, without proper guidance businesses are often not handled properly, adversely

affecting everyone involved.

This article discusses various strategies for dividing businesses during divorce.

When business division is involved, divorce lawyers, business lawyers, and tax lawyers are often required due to the complexity. For example, engaging a business attorney early in the process can help issue spot during Due Diligence and subsequent phases. They can review company documents, voting rights and privileges, creditors, and disclosures for potential issues. They can determine if a non-compete agreement is needed and help with key terms of the division, security of business interests, and structuring a tax efficient approach.

There are three ways to divide businesses:

- **Buy-Out** of One Spouse by the Other: This option is usually preferred, but not always possible. It requires a business valuation, which is usually a hotly contested topic in divorce as one spouse (the seller) usually wants the highest possible valuation and the other spouse (the buyer) usually wants the lowest possible valuation. In addition, the buyer must have access to the funds needed to execute the buy-out.
- **Sale** to a 3rd Party: This option occurs when both spouses sell their business ownership interests to a 3rd party. This requires a buyer who is willing to pay an acceptable price to the spouses. Often times, buyers are only willing to pay prices that are too low to be acceptable to the spouses.
- If a Buy-Out or Sale is not possible, particularly in time of economic crisis, the alternative option is **Co-Ownership**. This option can be challenging, complex, and risky.

### **Co-Ownership: The Complex Default Option**

Co-Ownership involves both spouses maintaining an interest in the business. This is usually a temporary arrangement until a buy-out or sale can be arranged or the financial crises ends. These arrangements are often complex. Key items in a co-ownership agreement include:

- **Option to Purchase a Spouse's interest** in the business
- **Rights to Financial Benefits** (Economic rights): Financial payouts are typically proportional to ownership percentage, and profit distributions follow equity percentage.
- **Management and control**: Management and control of the business is typically given to one spouse who acts as the manager.

An **In-Kind Approach** to Co-Ownership creates a subordinate class of equity for the non-operating spouse. This new class of equity has reduced voting and management rights. Thus the spouse can still reap the financial benefits but does not have management or control over the business. Although appropriate for many small businesses, larger businesses will have other 3rd party owners who may object and complex ownership structures that may limit what can be done.

In some cases, a **Holding Company** may be more appropriate. In this scenario, a holding company is created to jointly hold the spouses interests. This limits the changes needed by the rest of the ownership, as the holding company essentially replaces the spouses interests with no further changes. That being said, a key challenge of the holding company approach is the selection of entity for the holding company: Limited Partnership, Limited Liability Corporation (LLC), C-Corporation (C-Corp), S-Corporation (S-Corp), or Trust. The selection of the entity is complex because the entity of

the operating company limits the entity options of the holding company. For example, if the operating company is a Limited Partnership, the holding company cannot be a partnership or C-Corp. Instead, it must be an LLC, S-Corp or Trust.

## **Professional Corporations**

Co-Ownership of Professional Corporations (e.g. medical practice, law firm) is challenging because state law limits who can be owners. One approach is to have the operator spouse (e.g. the doctor operating the practice) to continue to hold the interest of both spouses, with accountability to distribute the income appropriately. Understandably, the non-operating spouse may be reluctant to accept this approach.

In addition, this approach introduces bankruptcy risk: because the operating spouse holds title, there is a risk that the spouse's creditors can attach the entire interest in the event of bankruptcy. The only way to avoid this risk is to divide the interest and confirm the divided interests as each spouse's separate property, but that may not be allowed by the professional corporation.

## **Collection Account Management**

Finally, another approach is Collection Account Management (CAM). CAM is an escrow, used in the entertainment industry. In a CAM, payments (e.g. royalties) are sent directly to a neutral party. The neutral party then distributes payments per their instructions.

## **An Integrated Approach to Division of Businesses During Divorce**

At Hoge Fenton, we take a holistic approach to advising our clients through the divorce process that include family law, corporate law, tax, and estate and trust. Our lawyers work closely together, and our family law attorneys can quickly and cost-effectively get business, tax, and even estate planning counsel as needed. This results in better outcomes for our clients during the most important legal situations of their lives.



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## **We are Here to Help**

Hoge Fenton understands that our clients, employers, and organizations may have numerous questions and concerns about reopening their business. As you begin to face the business and legal implications of the COVID-19 crisis, our attorneys remain committed to assisting you overcome these obstacles.

To provide some guidance on some of the issues that have affected or will be affecting businesses, we have created a **Reopening California** resources page to support you in the following areas:

- **Bankruptcy Information**
- **Corporate & Business Law**
- **Employment Law**
- **Family Law Counseling & Litigation**

- **Intellectual Property**
  - **Real Estate and Land Use**
  - **Tax/Trusts & Estates**
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**06.01.2020 | Firm Post**



The California Supreme Court is set to provide guidance on an issue that could have far-reaching implications for real estate, bankruptcy, and divorce.

Interestingly, this situation is arising via a bankruptcy case, not a family law case. In the 9th Circuit Court of Appeals bankruptcy case, *In Re Brace* (No.17-60032) the 9th Circuit has sought guidance from the Supreme Court of California in considering the following situation:

- a husband and wife acquired property jointly from a third party as joint tenants;
- the husband, alone, initiated a voluntary Chapter 7 Bankruptcy case;
- the bankruptcy trustee sought to include wife's (non-debtor's) interest in the bankruptcy estate.

The question at hand is: can the creditors (to whom the bankrupt husband is indebted) include the wife's one-half interest in the bankruptcy proceedings, or is the wife's interest protected because the property is titled as joint tenants (rather than community property)?

The California Supreme Court will address conflicting points of California Law:



- The manner in which legal title is held is presumed correct and, when held in joint tenancy, only the debtor's one-half joint interest in property becomes part of the bankruptcy estate, or
- Property acquired during marriage is presumptively community property owned equally by the married couple and thus included in the bankruptcy estate

The following important questions may be answered in the Court's decision:

- Can a purchaser rely on the form of title as conclusive when purchasing a property from the spouses or must they infer community ownership?
- What benefits and protections will apply to different forms of title?
- For parties intending to change the property ownership from community property to separate property, what standards apply beyond mere titling?

Stay tuned for our analysis of the Court's decisions and its implications on your practice.

Despite COVID-19 related limitations, Hoge Fenton continues to meet new clients and advocate on their behalf. In addition to being highly skilled, Certified Specialists in Family Law, our family law attorneys are integrated with our attorneys in other practice areas. This provides several financial and emotional benefits for our clients, such as:

- **Minimizing your taxes:** our attorneys communicate closely with each other to minimize the tax implications of division of property, business, and other assets
- **Crafting a new estate plan for your new situation:** we can revoke an existing estate plan and work with our estate planning counsel to implement a new estate plan that is optimized to your situation
- **Protecting your business interests:** we structure transactions, distribute business interests (including IP), and assess ongoing litigation
- **Maximizing your real estate outcome:** we work through division and sale of real and commercial property during dissolution to assess benefits and pitfalls such as capital gain impacts

Dealing with domestic violence can be difficult, both emotionally and legally. Please reach out to our experienced Family Law attorneys if you need support.



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**If you or someone you know has been a victim of domestic violence, don't delay in getting help. The court system is available for you, even now. Your safety is a priority!**

In the U.S, since March 16, 2020, the National Domestic Violence Hotline has received 2,345 calls in which COVID-19 was cited as a condition of abuse, according to Crystal Justice, chief marketing and development officer **(source)**. Even before the pandemic, an average of 20 people in the United States experienced physical domestic violence every minute. Research shows 1 in 4 adult American women and 1 in 7 adult American men have experienced some type of severe violence – including being hit with something hard, being kicked or beaten, or being burned on purpose – at the hands of an intimate partner **(source)**. Domestic abuse can include non-physical abuse, including financial and emotional abuse.

**The Santa Clara County, Alameda County and Contra Costa County courts are still open for matters relating to domestic violence and emergency child custody issues.**

Here is how to get help if you're a victim of Domestic Violence:

- **Ensure your safety first. This should involve calling the police and possibly seeking shelter elsewhere. A police officer can initiate a request for short term protective orders (called Emergency Protective Orders).**

- **Contact a family law attorney.** Whether or not the police have intervened to seek short term emergency orders, you should contact a family law attorney. The family law attorney will submit your application for a domestic violence temporary restraining order (DVTRO) at your local Superior Court, so that a DVTRO can be granted ASAP (usually within 24 hours).
- Once a DVTRO is ordered, a process server or law enforcement officers will serve the defendant/accused with the order and the date of the initial hearing, which will be scheduled within 21 days after the DVTRO is issued.
- Your family law attorney will guide you through the rest of the process, as is appropriate for your situation.
- TROs last until a judge either extends the length of the original TRO, removes it, or replaces it with a permanent restraining order.

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