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Family Business and Divorce over the Years

Alexis Harper & Jenny Smith, Partners, Harper Macleod
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Business Interests on Divorce

Good morning everyone.

Over the last few years, Jenny and I have dealt with a number of cases in which a significant issue has been a small to medium sized business interest. These businesses have ranged from tobacco sales, a fishing company, a haulage company to an automotive vehicle business, a sole trader farmer and a hotel partnership.

The issue of business interests on Divorce has also been in the spotlight recently with the reported decisions of SCA v MMA [2020] CSOH 54, (appealed, unsuccessfully, [2020] CSIH 66) which involved sole trading, partnership and limited company interests, McCallion v McCallion [2019] CSOH 100 (appealed, again unsuccessfully, [2020 CSIH 43) and ASA v AZD [2020] CSOH 63. All well written judgements which are worth a read.

What we hope to do today in our 25 minute presentation is have a look at the common different business structures, (so, sole trader, partnerships and limited company) that we come across and their respective implications from a family lawyer's perspective. We will look at our own experiences over the last few years and the issues that we have come across as well as looking at case law to try and pick out some of the lessons that can be learned from those decisions.

Back to basics, but let's first look at the different types of business entities we come across:

1 **Sole Trader**

A sole trader runs their own business as an individual and they are self-employed. They keep their business profits after payment of tax and they are personally responsible for any losses the business makes. There is no separate legal persona and the business belongs to the individual wife/husband at the relevant date.

2 **The Partnership Interest**

A partnership is the relationship of two or more partners carrying out a business with a view to making a profit. The partners are responsible for running the business. They share the profits between them and they are personally responsible for paying the bills (apart from LLPs).

3 **The Limited Company**

This is one of the most common entities that one comes across in the context of Divorce. A limited company is a company limited by shares or limited by guarantee. The ones limited by shares are the most relevant here as these are usually businesses that make a profit. The company is legally separate from the people who run it, it has separate finances from personal finances, it has shares and shareholders and they can keep any profits after paying tax. Often a sole trader will become a limited company usually on advice of tax advisor/accountant. On other occasions the business might be large and very profitable often within the ownership of one or both of the spouses for a number of years.

So let's look in more detail at some of the issues that can arise.

Sole Trader

In a sole trader situation if this has been started during the marriage and is in existence at the relevant date – the value of the business at the relevant date will be matrimonial property. This should be relatively straightforward.

But what if the party to the marriage had set up the sole trader business before marriage and that business continues to trade and acquire assets during the marriage up to the relevant date? As I have said a sole trader does not have a separate legal persona – the business belongs to the individual and the assets of that business that have been acquired during the marriage by the business are matrimonial property so then those that were acquired prior to the marriage are not matrimonial property.

But what about if an asset that was in the sole trader business prior to marriage is used to purchase a new asset for the business during marriage?

This would be a special circumstances argument due to the source of funds of asset used to acquire new asset.

Example of sole trader scenario:
Scenario 1 - The sole trader – Mr & Mrs Macdonald

- Parties married 1 July 1990
- Separated 15 December 2016
- No children under age of 16
- Mr M was a sole trader of a farming business which had previously been a partnership with his mother and father
- Mrs M raised Divorce action seeking capital sum of 1.5 million, this however was based on her assumption that Mr M's farming business was entirely matrimonial property
- As a sole trader business and essentially a sum of its parts we had to look at assets of the business and when/how those were acquired
- What became clear to Mrs M's lawyers in the context of the case was that a large proportion of the business (the majority of the land) was acquired by way of inheritance from Mr M's father and mother – this could all be shown from the land register and confirmation of their estates.
- There was land, stock, plant machinery and money in the bank and liabilities that were acquired during marriage for consideration and we had those items valued at the relevant date and Mr M's accountant then prepare a value of the business that was matrimonial property – that was however significantly less than the total value which included inherited items.
- Wife also had section 91b claim re the fact Mr had sold non matrimonial assets of the farm and reinvested them back into non matrimonial land but because she also had her own assets (uncommon for a farmer's wife) we were able to resist her 91b claim in the context of settlement and instead proceeded on 50/50 split
- Resources were an issue – Mr had a pension, a policy and some money in the bank but that was it – wife wanted all in cash – had to obtain letter from bank that he could not borrow more on the farm – would not be reasonable for him to sell the farm (as to be passed on to the son) and as such wife had to take part cash/part pension.
- Points to note – full analysis of sole trader business required, corporate advisors to consider implication of business owner acquiring land during marriage that is not inherited, resources are very relevant here and also be aware of section 91b.

Partnerships

Let's look now at a Partnership. In a partnership there will often but not always be a written partnership agreement. If not and it is a partnership at will the rights of the partners will be determined by express or implied agreement of the parties, failing which the Partnership Act 1890.

If the interest in the partnership was acquired before marriage, the interest held at the relevant date, assuming the same percentage will not be matrimonial property.

If the partnership consists of one of the spouses and a third party, then the spouse's interest still needs to be valued in the context of divorce, This was relevant in SCA v MMA [2020] CSOH 54 and subsequent (unsuccessful appeal). Here, part of the defender's business empire was a restaurant owned by a partnership, with the partnership consisting of the defender and his father. The father was very supportive of his son at proof and gave evidence he would object to a sale. The judge at first instance however took the view that if there was a reasonable financial incentive for him, he would not stand in the way of realisation of partnership interests. The basis of the defender's appeal was that his father's evidence should have caused the judge to reject the partnership valuation on which she relied in her calculations. He argued it was an error of calculation on her part and as such the matrimonial property was overstated, The appeal was unsuccessful. The main reason for this was that the argument was not put to the judge at first instance. She was not invited to recalculate on the basis of that argument. Learning point, ensure you properly cover all points you intend to rely on at proof. The appeal court also noted, and this is a point to bear in mind when considering an appeal, the more general problem that even if the appeal court did see merit in the ground of appeal, it is not in a position to unscramble the judge at first instance's figures and identify appropriate alternatives.

What it the husband and wife go in to partnership together and set this up during marriage and before the relevant date? The partnership has a separate legal persona. Each partner will have a figure in their capital account which represents his/her share of the value of the partnership. The assets which went into their respective capital account during marriage will be matrimonial property (unless the partnership agreement, if there is one, states otherwise).

Consider the scenario where that partnership owns heritable property. You might think that one of the spouses could seek an order for the sale or the transfer of that property. You would be wrong in thinking that however.

The case of *Clark v Clark* 2007 SLT (Sh Ct) 86 dealt with this issue which held basis that the heritable property was owned by the legal persona that was the partnership and the basis upon which the property could be sold would be determined by either the partnership agreement or the Partnership Act 1890.

So, one to bear in mind for any cases involving Partnerships.

Another issue potentially in partnerships held by husband and wife is that after the separation one of the spouses could formally resign from the partnership. That would then require the partnership to be dissolved and how that will be dealt with will be covered either in a Partnership Agreement or the Partnership Act 1890. This leaves all sorts of issues – what if one partner's capital account was in debt at the relevant date? This would be a matrimonial debt and arguably should still be taken into account. What about the Partner who doesn't resign but effectively takes a back seat from the Partnership after separation due to the circumstances? You then might need to look at an accounting for any profits post separation or conversely for any debts incurred.

Example of partnership scenario:
Scenario 2 - The Partnership – Mr & Mrs Dodds

- Married on 21 October 1990.
- Separated on 1 July 2013.
- No children of the marriage under the age of 16.
- Apart from matrimonial home (with little equity), main asset was a partnership which operated a hotel business. The parties were partners of and trustees for the partnership and held the registered title in respect of the hotel. There was a security over the hotel owed to the bank.
- Mr Dodds was more heavily involved in the running of the business during marriage and post separation until in or around 2017. Thereafter Mrs Dodds took more of an active role in the business and Mr Dodds back seat.
- Mrs Dodds wished to continue running the business as a limited company. Mr Dodds was agreeable to this so long as he received a fair share of its value.
- The parties were able to agree a value for the hotel.
- However, a major issue in the case was agreeing the liabilities of the partnership. Mrs Dodds was taking on the business. There had to be an agreement about the liabilities of the partnership and what Mrs Dodds was taking on. Mrs Dodds was concerned that the way in which Mr Dodds had operated the business had accumulated liabilities. There was a dispute between them as to exactly what their liabilities were.
- Corporate involvement was obtained from the outset as soon as they had reached a broad agreement that the business would be transferred to Mrs Dodds.
- As well as entering into an extract Minute of Agreement, the parties entered into a Dissolution Agreement in respect of the partnership which was signed contemporaneously with the Agreement.
- The partnership was to be dissolved with effect from the date of the Separation Agreement being signed and the Dissolution Agreement being signed.
- The business assets of the partnership would be transferred to the limited company set up by Mrs Dodds.
- The heritable title to the property was held in the name of partnership – real estate/commercial property were involved to transfer the interest in the property out of the partnership into the name of the wife. The Agreement had to ensure that Mrs would free and relieve Mr of all liabilities of the partnership subject to any warranties, indemnities or other obligations given by him in terms of the Dissolution Agreement.
- Alongside the extract Minute of Agreement there was the Dissolution Agreement entered into between the parties the wife's limited company and the partnership. The Dissolution Agreement was comprehensive. Employment advice was also sought in relation to TUPE Regulations (the Transfer of Undertakings) (Protection of Employment) Regulations 2006.

- Corporate input was essential to ensure all proper drafting of the Agreement to ensure that both parties obligations were correctly narrated within the Dissolution Agreement.

- Mr Dodds had to warrant to his wife and the company that there were no outstanding liabilities over the partnership known to him other than agreed liabilities which were listed. Mrs Dodds did the same. The company was to assume responsibility for indemnify Mr Dodds against the payment performance in any actions, losses, damages, liabilities, charges etc which may be paid, incurred, suffered or sustained by Mr Dodds arising out of or in connection with the agreed liabilities. Mr Dodds was indemnifying and holding harmless his wife and the company against the payment performance and any actions, losses, damages, liabilities, charges, claims etc suffered or sustained by Mrs or the company arising out of or in connection with any liability of the partnership which did not form part of the agreed liabilities save for any liability of the partnership that Mrs Dodds had incurred without Mr Dodds knowledge – there were various other indemnities and warranties included. There had to be provision for taking on of the contracts and dealing with the employees, alcohol licence, various guarantees, restrictive covenants etc.

- Important points to note – corporate input essential, get corporate involved from outset. There will be lots of things they will consider that you will not and it is essential that they are involved. It is not wise to do this as part of just a Separation Agreement.

- Beware of assuming that heritable property is the name of the parties personally, in this case it was held in trust for the partnership and commercial property experts are required to be involved.

- Cautionary tale for corporate advisors when thinking about husband/wife partnerships – think of the implications on Divorce. Think of the implications of the partnership continuing to operate after separation and the issues that can arise – to ensure proper accounting to other partner of profit and to think about the debts arising post separation.

<u>The Limited Company</u>

And finally, the limited company. This is probably the most common business structure that we come across in the context of Divorce.

If the company is in the sole ownership of the husband or wife and those shares were acquired during the marriage, then those shares are matrimonial property. Their value must therefore be ascertained. A formal valuation will need to be undertaken by an accountant who will decide the best way to assess the value at the relevant date.

<u>Valuing a Business</u>

Once it has been established that a business interest is matrimonial property, it is going to need to be valued as with any other matrimonial asset.

Valuing a business is not straightforward, unless it is very clear it was simply set up as a tax efficient method of managing income (eg, an IT contractor who invoices through the company, and where the company has limited/no assets, heritable property and just a business bank accountant). A forensic accountant will generally need to be employed. They will need to have sight of the three years' full accounts leading up to the separation at the very least, but in practice are likely to require considerable more information from the business owner and the business accountant. It is important to instruct the right valuer with the requisite level of experience. It is tempting for the business owner to instruct somebody who they think will produce a favourable valuation for them however this needs to be a credible report from an expert who has the relevant experience as otherwise the client would be exposed to significant risks. Often a surveyor will also be required, to provide valuations for properties which are then fed into the accountant's report. Expert witnesses must be impartial and independent.

This was highlighted in the case of *Watt v Watt* 2009 Fam. L.R.

This was a fishing case. Here, the husband pursuer relied on an expert witness to value the shareholdings who was a partner in Johnston Carmichael. That firm had been the pursuer's accountants since he started fishing about 30 years before, although his main contact there was Billy Smith. The expert witness was another partner in the firm, Iain Webster.

Prior to raising the court action, the pursuer sought advice from Johnston Carmichael about the value of his shares, with Johnston Carmichael preparing what they termed a "share valuation memorandum". Iain Webster was involved in preparation of that document. It was not lodged as a production in the divorce action.

For the purposes of his report for the divorce action, Mr Webster relied heavily on information provided to him by Billy Smith, particularly relating to the valuation of the fishing quota as he considered Mr Smith an expert in that field.

The court concluded that Iain Webster's evidence was not reliable, stating "The fact that the pursuer was and remains a client of the firm of which he [Iain Webster] is a partner means that a question is immediately raised as to whether he is truly independent……. I had, rather, the impression that he sought to act as advocate for the pursuer. When I add to that my observations regarding the discomfort he displayed when cross examined as above, I am reinforced in my conclusion that I cannot rely on his valuation evidence".

The court's approach in *Watt* was replicated in a 2019 case at Glasgow Sheriff Court of *AF* v *AF* [2019] SC GLA 22 (14 March 2019) where the Sheriff refused to admit the evidence of a witness purporting to be a skilled witness, on the basis that as well as not having the required experience and knowledge, the person was neither independent nor impartial.

The 2020 decision of *SCA v MMA* echoes this, with the judge concluding that the Defender's surveyor allowed himself to be influenced by the defender's views and so departed from the "necessary position of impartiality of a witness" (per Lady Wise).

What of the scenario where the spouse has decided to put shares in the company in their husband or wife's name during the marriage? Those shares will also be matrimonial property but often the person who operates the business will want those shares back. They can seek a transfer of those shares within the context of a Divorce but they will be recovered at current value. Again if corporate advisors are involved in advising clients on the benefits/risks of transferring shares to their spouse they need to consider that whilst there might be some income tax benefits in doing this, if they separate and they want those shares back it will cost them. The other issue of spouses both holding shareholdings and in particular equal shareholdings is that in the event of a separation one spouse can hold their spouse to ransom or prevent a sale of the business, I have seen a situation like this whereby the disgruntled spouse was able to hold off bringing matters to a conclusion for a number of years after separation which maximised her return because the business which they owned jointly (and which she played no part in the running) continued to increase in value and was eventually sold for over a million more than the valuation she had instructed a year before. The husband had hoped that he could buy the wife out a lower value and then sale for a higher amount later but her 50% shareholding allowed her to hold out for more and place the husband in a situation where he had no choice but to have her share in the sale proceeds. Of course now, in the midst of the pandemic, the converse is just as likely to apply, with the business dropping in value since relevant date, *SCA v MMA* being an example of this.

In addition to this, often a business owner will want to involve his or her spouse in the business for example by adding them to the pay roll and giving them marketing or other admin type roles. It may be attractive for them to do so from a tax perspective but corporate and employment lawyers should be aware of the consequences of this if the parties separate. It is not a simple case of sacking your spouse when you split up – they would be at risk of employment law ramifications such as unfair dismissal. If the business is not matrimonial property but the non-owner is working for the business there are risks they could attack the value of the business in some way for example by a section 9(1)(b) claim. A typical argument is where the spouse has assisted in the business, contributing to its success and growth but has been paid at less than the rate a third party should have been paid at for the work done. Ini that situation it may be necessary to instruct an expert employment report, to back up the argument that the spouse has been underpaid.

Also, if corporate lawyers are involved in advising on a restructure of a company they should be thinking about the potential implications for this on Divorce so it is a question of a corporate lawyer asking the question – how is your marriage? This is probably not a forum a corporate lawyer is used to entering!

Example of limited company scenario:
Scenario 3 - the Limited Company – Mr & Mrs Carmichael

- Company incorporated during marriage.
- Sole shareholders are husband and wife, Mr Carmichael has 75% of the allotted shares, Mrs Carmichael has 25%. So, the shareholdings are matrimonial property, having been acquired during the marriage.
- Mr Carmichalehas been the driving force behind the business.
- Mrs Carmichael has taken care of the children and the home, gave up work after birth of first child. Both are paid salary (albeit the wife does not work in the business) and take dividends.
- Additionally, Mr Carmichael is a shareholder in another company (with a third party as the other shareholder), which was set up using pre-marital funds on his part.
- Parties separate…….in a bad tempered way.

Our soft skills come into play here just as much as the black letter ones, in dealing with reluctant participants.

There are lots of family law implications flowing from this scenario.

First point to consider is do we need an order for the business to be anonymised in reporting? It could affect a future sale if interested parties could access detailed financial information about the business. I understand (though it is not reported in the judgement) that such an order was successfully sought in the case of *SW* v *TW* [2013] CSOH 136, where the business is referred to simply as X Limited.

The next one to consider is valuing business for the purposes of separation/divorce. The basis to be used is that of the hypothetical willing buyer and seller, per the case of *Sweeney* v *Sweeney*. This is even if no buyer actually willing to come forward. In the 2020 case of ASA v AZD the pursuer accepted that she was very anxious to sell shares which would might not represent a realistic willing buyer willing seller transaction as at the date in question one party was not able to hold out for the best reasonable price whereas the other was in a strong position to offer a lower than market price.

Value of business. Likely to be dispute about valuation because the forensic accountants are likely to apply different multipliers etc. Very nuanced. Vital to have a good and independent forensic accountant on board, who can produce a good report, comment on the other side's report and also is able, if necessary, to give evidence in court/withstand robust cross examination.

As well as "relevant date" value (ie as at date of separation) for the shareholdings, you will also require current value, if a transfer of shares from Mrs Carmichael to Mr Carmichael is envisaged and also for information about resources. The business valuation report is likely to be a costly exercise, especially as there will probably be follow up work required, such as the valuer attending consultations, commenting on the other side's report, meeting with that valuer to narrow the issues in dispute in advance of Proof, updating his/her report (it was noted *SCA v MMA* that the Defender's forensic accountant had not been told that certain property valuations were agreed after issue of his report/he accepted this affected his valuation) ….and so on.

It is important to obtain a fees quotation from the accountant and ensure your firm is in funds to cover this before the report is instructed as otherwise your firm will be liable for the cost. The forensic accountant may end up being asked to comment on other aspects in the case. For example, the business owner might want to start paying himself a higher salary in order to fund legal costs or other expenses. However, care must be taken to ensure that the salary is not higher than someone in that role could expect to receive. This could lead on to having to instruct an employment expert to prepare a report commenting on appropriate salaries.

Bear in mind too that valuations from surveyors may also be required, if the business owns heritable property. The valuations in the accounts may be historic and in need of an update. If heritable property is leased out then the valuer will need to consider the lease terms in determining value.

Going back to our scenario, there may also be the issue of directors' loans; either monies lent to the company (asset for the party) or vice versa (debt). This will likely involve detailed analysis of directors' loan accounts.

In our scenario Mrs Carmichael only has 25% of the shareholding.

This leads on to the issue of whether a minority discount should be applied? After all, a willing buyer would not pay full cost for a minority shareholding.

But minority discount argument won't work if the company is sold:

Jackson v Jackson 1999 Fam L.R.108

Parties were the only shareholders in a private limited company. The wife pursuer held 49.73 of the shares. Her Counsel argued that the value of her shares should be discounted to reflect the fact that she was a minority shareholder. If successful, this would have the effect of reducing the pot of matrimonial property in her sole name. It was argued on her behalf that a discount of 30 per cent should be applied. Counsel for the defender argued that whilst such discounts would be appropriate in valuing the interests of an individual shareholder, it was not appropriate in the context of valuing the entire shareholding in the company and in circumstances where it was agreed that the company would have to be sold. So, the Court held that it would not be appropriate to include parties' interests in the company on an artificial basis which would not be reflected in the events which were going to happen (that is, the company would have to be sold). This illustrates that trying to argue that a minority discount should be applied is unlikely to be successful where it is clear the company as a whole will have to be sold.

One counter argument to applying a minority discount which is often advanced is that the company was operated as a quasi-partnership and therefore no minority discount should apply. This is where it is important to get a detailed background from the client about the history of the entity to establish whether there is scope to argue for/against this.

Your business valuer can apply a minority discount but cannot comment on the legal position as to whether the court should apply it. Again, this is a very nuanced area and the client should be told no guarantee of success. Promise low, deliver high tends to be my philosophy in these situations.

We then come on to exploring settlement options. Key to being able to do this properly is an accurate schedule of matrimonial property listing the relevant assets and taking into account any liabilities which form the pot of matrimonial property. Where there is significant divergence in valuations (eg between the 2 business valuations) that also needs to be borne in mind (so that exploring options is done as comprehensively as possible, with worst and best case scenarios set out). Part of our job as family lawyers is being able to produce schemes of division illustrating the different options which are easy to follow for clients who may not be used to dealing with finances. Excel is our friend here.

The husband in our scenario wants to buy out his wife's shares. So, not only must he account to her for the value of his shareholding at relevant date but must also find resources to buy her shares, which have to be valued at current date (where we are looking ta transfer of an asset, "appropriate valuation date" must be used per s.10(8)(1)(aa) of Family Law (Scotland) Act 1985, with that defined as either date the parties agree or the date of the making of the order. In practical terms this means in most cases current value is used.

Value of wife's shareholding may have gone up or down since the date of separation.

There may well be a funding issue for the husband. He will need input from accountants, tax advisors, company lawyers on how to fund and structure the best settlement for him.

Would an option be for the wife just to keep her shares? That is unlikely to be attractive to either party. Husband's ability to issue dividends restricted. Wife presumably wants out of the business altogether. She has played no role in it to date.

Husband purchases shares from personal funds? How does he finance this? It may simply not be possible. Plus it will be coming out of already taxed income.

Resources issue. The husband may need to ask court to reduce the sum due, or for it to be paid in instalments. In *SCA v MMA* Lady Wise decided partly due to the impact of the Covid pandemic on trading that the capital sum payable by the defender should be payable in instalments, with interest falling due on each instalment fomr the date when it is due. This was appealed by the pursuer who argued that interest should be on the whole sum form the date of Lady Wise's interlocutor but appeal was refused. Wife may then argue a need for periodical allowance, on the basis that she needs support pending receipt of the capital sum due to her. This will in part depend on the rest of the structure of the overall settlement, the assets she will be retaining and their nature. She will cease to be an employee of and receive a salary from the company, so will likely need employment law advice. She will no longer receive dividends, assuming her shares can be transferred.

Tax. The case of *Sweeney* v *Sweeney* 2004 SC 372 illustrates that it is not acceptable to value business interests on the basis of a notional sale then deduct Capital Gains Tax that would be due at that date. However, it opened up the possibility of arguing special circumstances, ie that a contingent liability to CGT (eg if a party has to sell shares in order to pay a capital sum) might constitute a special circumstance justifying unequal sharing. In *Sweeney,* the court held that the husband had failed to establish that there were special circumstances by reason of tax liability. *Sweeney No 2* [2005] CSIH 65 shows that there is a sliding scale, in terms of where does each case lie on a spectrum between never selling the business and having a purchaser waiting in the wings.

In the case of *SW v TW [2013] CSOH 136* the defender sought an adjustment in the sharing of capital to take account of his future liabilities to firstly capital gains tax on sale of shares transferred to him by his wife and secondly income tax on dividends he might need to use to pay a capital sum. Lord Tyre held that he was not precluded in principle from having regard to such potential liabilities. He held it was appropriate to make an adjustment in respect of the defender's prospective liability to capital gains tax and justified by special circumstances. He deducted 10% from the value of the shares. This was based on making an order that the wife's shares would be transferred to the husband. In reaching this decision he said he was satisfied a sale of the shares was by no means hypothetical. He did not hold that a special circumstances argument could be advanced in relation to the defender's obligation to pay income tax. The 10% figure was not arbitrary, however. Instead, it took into account that the defender, on sale of the shares, would pay capital gains tax, presumably at the entrepreneur's relief rate of 10%.

Lord Tyre also considered the application of section 8(2) of the 1985 Act (making an order for financial provision that is reasonable having regard to parties' resources) in relation to the defender's resources to fund a capital payment due to the pursuer based on the pursuer's shares being transferred to him (which both parties sought). Lord Tyre ordered the payment to be made in three instalments, not on the basis that the defender did not have resources but that they were not readily realisable. Whilst the company had built up significant reserves, the extent to which the defender could take dividends could not be allowed to prejudice the other shareholder, AB.

Another possibility may be a share buyback by the company? A court cannot order this but it can be done in the context of negotiations. The company would need to get clearance from HMRC. Certain criteria must be fulfilled in order to obtain clearance (beyond the scope of this talk). Company law and accountancy and tax advice are crucial. The advantage of a share buyback is that client does not have to find the funds personally, and gets his aim of full control of the company (since wife's shares would go back into the unalloted shares and he would retain his existing shareholding). Disadvantage is it will deplete the company's funds (and of course will only be possible if the company has sufficient funds in the first place).

The final part of our scenario, the other company in which Mr Carmichale has a shareholding, requires us to consider special circumstances. This matter featured in *McCallion v McCallion* [2019] CSOH 100. The pursuer appealed the decision, unsuccessfully, ([2020 CSIH 43]). Both judgements are worth a read.

The appeal was in two parts.

Firstly that the judge at first Instance (Lord Glennie) failed to take account or give proper weight to the reclaimer's contribution to the pool of matrimonial property from IP rights he had acquired from his own efforts prior to marriage.

Secondly, Lord Glennie had erred in determining the reclaimer's conduct in relation to the tax consequences of the disposal of shares during the marriage amounted to a special circumstance/dissipation of assets or otherwise was conduct which required to be corrected by payment of an additional capital sum to the respondent.

So, this case involved consideration of section 10 (6) (b) and (c), and also s.11 (7) (impact of conduct adversely affecting financial resources).

Dealing with the first part of the appeal, the pursuer & reclaimer argued the judge did not give fair account to the non-matrimonial source of shares (special circumstances under s.10 (6) (b)). He argued that the decision failed to recognise the argument under section 9(1) (b) that the respondent had been given an economic advantage because the sum secured on sale of the shares stemmed from the reclaimer's pre-marital assets. But a large part of the value of the shares in question arose during marriage so it could not be said that any particular part of the proceeds of sale represented pre-marital assets. In this case, and before marriage, the pursuer had acquired and registered a number of intellectual property rights which in 2009 (during the marriage) were assigned to a limited company in which he held 40% of shares (a third party held the rest). The judge at first instance concluded that the large part of the value of the shareholding in the company (UPAL) arose from work done in exploiting the IP rights after the marriage and that therefore no particular part of the proceeds of sale of the shares represented pre-marital assets. In the appeal the judges commented that no attempt was made during the proof to value the IP rights, separately or as part of the shareholding, or to lead evidence which would have enabled a conclusion to be reached that there was an identifiable pre-marriage value which could be reflected in the decision. The learning point here is the importance of properly attempting to quantify pre-marriage contributions.

The defender for her part had argued s.10 (6) (c) (destruction, dissipation or alienation of property by either person). There was a CGT issue but it was to do with whether the pursuer ought to have disclosed a disposal on his 2012/13 or 2015/16 tax return (if former, tax at 10% as get entrepreneur's relief, if latter then 28%). This was incurred when the pursuer exercised an option for the other shareholder to buy his shares, which option he exercised in June 2012. The defender averred that the pursuer dissipated assets/his conduct adversely affected the matrimonial property by his failure to disclose at the earlier date (because he received less for the shares as had to pay more tax). Lord Glennie said "I am satisfied that this depletion of the matrimonial assets by the pursuer amounts to a special circumstances falling within section 10(1) and 10(6)(c) of the Act justifying a departure from the principle of equal sharing. He was satisfied that this merited a departure from equal sharing. The pursuer & reclaimer unsuccessfully attempted to appeal this, He submitted that Lord Glennie had incorrectly interpreted sections 10(6) (c) and section 11 (7) of the 1985 Act. The appeal court held that Lord Glennie had not erred in concluding section 10 (6) (c) applied and in using section 11(7) as a cross check to determine whether there was a basis for taking conduct into account. This is a helpful analysis of the interaction between these sections (they are not synonymous or interchangeable) and of the successful operation of a dissipation argument.

The 2020 case of *SCA v MMA* also considered the impact of source of funds. Here an unequal division 58:42 in favour of the defender was awarded. This was because the defender inherited his brother's share in most of the business assets (in broad terms around 1million plus 2 properties) and stated he would take on the burden of settling his late brother's tax liabilities. The judgement describes the careful counter-balancing exercise which has to be carried out in assessing the strength of the source of funds argument and how very case specific this tends to be; here, Lady Wise accepted if the brother had lived he would have remained in business with the defender, on the other hand the defender through his own efforts enhanced the value of the business considerably during marriage. Lady Wise sums up nicely the nub of the matter, stating "What I must achieve is a balance that seems fair and reasonable having regard to the undisputed history of the origins and development of many of the business interests that now comprise matrimonial property".

There is then the thorny issue of quantification of the special circumstances argument. Lady Wise notes that it is rarely appropriate to effect some sort of reimbursement of the value of inherited wealth, with or without an adjustment to reflect relevant date value.

Lots for the clients to think about….underlines the need for good family law advice and a good team generally; Advocate, family lawyer, forensic accountant, input from financial and tax advisers, corporate input, employment law advice, pensions advice (eg if SIPPs or SSASs are involved)….the list goes on.

To conclude……

All doom and gloom? No….not if business owners get good advice before making big decisions and changes. To avoid what I have talked about having to pan out in all its complicated, costly drama. So, before marrying, cohabiting, re-structuring, setting up a new business, selling….really, any big changes.

Corporate, tax, accountancy but also family law advice too. Consideration can be given about whether to enter into pre or post nuptial agreements or cohabitation agreements or whether there is an alternative way forward which will not have as potentially serious consequences on separation/divorce. All of us, not just the family lawyers, need to be asking "How's your marriage/how's your relationship"…..

For lawyers working in other areas, family law is often seen as an "easy" area of law – you simply add up the assets and divide by two. Whilst this may the case for some situations, where businesses interests are involved, that is generally not the case. There are many issues that need to be carefully considered and resolved.

There are a variety of business structures that a family lawyer comes across in their day to day work and there are often complex issues to consider. We hope that you will take some helpful pointers from this talk that will assist you all in your cases.