

Protecting Your Business from Divorce

Unfortunately, by the time a marriage is breaking down, it is frequently too late to take the steps necessary to protect your business assets from a soon-to-be ex-spouse.



BY NAIM D. BULBULIA, ESQ., AND JONATHAN W. WOLFE, ESQ.
SKOLOFF & WOLFE, P.C

WHEN BUSINESS OWNERS COME INTO OUR offices to discuss getting divorced, one of the first questions that they ask is, “What can I do to protect my business?”

Unfortunately, by the time a marriage is breaking down, it is frequently too late to take steps necessary to protect business assets from a soon-to-be ex-spouse. The ideal time to protect a business (or any other asset) is before an individual gets married, by utilizing a prenuptial agreement.

Alternatively, parents seeking to transfer a business to their children (either by sale, gift or upon their death), can utilize a trust to protect the business they established from the current or future spouses of their children.

Equitable Distribution. Before we discuss prenuptial agreements and trusts, it is necessary to understand how assets are divided in the event of a divorce absent a prenuptial agreement and when assets are not held in trust. Under New Jersey law, a marriage is treated as an “economic partnership,” and upon divorce the parties’ assets are subject to “equitable distribution,” meaning that a court will divide the assets pursuant to various factors established by New Jersey statute. Equitable distribution applies to all assets (other than gifts and/or inheritance) acquired by either party during the marriage regardless of title, and to the growth of certain assets that parties bring to a marriage (when the value or appreciation is the result of an effort or activity by either spouse during the marriage).

Equitable distribution includes all types of property that are acquired during the marriage (e.g. real estate, jewelry, investments, stock options, bank and brokerage accounts, retirement assets, businesses, life insurance policies, etc.). Courts must determine what property constitutes the marital estate, value each asset and divide the marital estate pursuant to the statutory factors.

Thus, absent an agreement to the contrary, if a business was started during the marriage, its value will be considered an asset to be divided between the parties. Typically, the spouse that has operated the business during the marriage will continue as the owner of the business and will have the obligation to “buy out” his or her former spouse’s interest. This can lead to a variety of problems when the “owner” spouse does not have sufficient liquidity to fund the payment of what can be a staggering obligation. Further, even in the event that the business was a pre-marital asset that would not be considered marital property, the increase in value of the business during the course of the marriage may be considered a marital asset subject to equitable distribution. In such cases, forensic accountants frequently must be retained by both spouses to establish the value of the business at the time of the marriage and at the time of the divorce. The dispute over these values (and the expert expenses) can significantly increase the cost of the divorce proceedings.

Prenuptial Agreements. In order to avoid disputes over valuation upon divorce and to protect the business, the parties could have entered into a prenuptial agreement. A prenuptial agreement is simply a contract between would-be spouses that typically addresses one or more of the following issues: (1) how assets owned by each party prior to the marriage will be disposed of in the event of a divorce; (2) how assets earned and/or acquired during the marriage will be divided of in the event of a divorce; (3) whether alimony will be required in the event of a divorce (and how it will be calculated if there is alimony); and (4) how assets will be disposed of in the event of one party’s death.

Although historically prenuptial agreements were most frequently utilized in the context of second marriages and/or in the case of the super rich, they are becoming much more commonly used in first marriages

continued on page 14

continued from page 12

and by a significantly broader segment of the population. Prenuptial agreements can be of particular significance to all individuals that own or anticipate acquiring a business (regardless of its size) during the course of their intended marriage. Such individuals can have a prenuptial agreement drafted to exclude the value of a premarital business (and all appreciation on said business) from the marital estate.

In order for prenuptial agreements to be enforceable under New Jersey law, each party must knowingly and voluntarily enter into the agreement, and each party should



In court, the best of intentions counts for nothing. You need a pre-marital agreement and estate planning to make sure your business survives a divorce.

obtain independent legal representation and fully disclose their assets. In addition, a court may set aside an agreement if it is determined that it was unconscionable either at the time of execution or at the time it is sought to be enforced. Thus, a prenuptial agreement that was entirely fair and reasonable when executed, may be set aside if a court determines that its enforcement would be unconscionable at the time of execution.

Additionally, courts may look to the proximity between the parties entering into the agreement and their wedding date to determine whether there was any undue pressure exerted upon a spouse when executing the agreement. Although courts have enforced agreements entered into in close proximity to a wedding, it is better practice—when feasible—to finalize the agreement well in advance of the parties' wedding date. In the event that can not be done, the agreement should include a provision that the parties were under no pressure and both freely entered into the agreement notwithstanding the proximity of the signing to the wedding.

Postnuptial Agreements. In addition to premarital agreements, married parties can enter into agreements during the course of their marriage to establish their respective rights in the event of divorce and/or death. Such agreements are known as post-nuptial agreements or mid-marriage agreements—or, if they are entered after a serious “rift” has developed between the parties—as reconciliation agreements. These agreements, however, can be treated less favorably by courts than premarital agreements. Indeed, some courts view such agreements made between married individuals as more inherently fraught with the danger of duress. Additionally, unlike premarital agreements, the consideration for the post-nuptial agreements cannot be the wedding between the parties.

If a married individual is starting a business during the marriage, his or her spouse is very unlikely to agree to

the exclusion of such business from equitable distribution, however, if such endeavor is funded by money from a parent, or if the business was recently inherited from a family member, such an agreement may be appropriate.

Trusts. An additional option for a business owner seeking to protect a family business from his child's current or future spouse is to place some portion (or all) of the business into one or more trusts. In the case that the business will pass on after death to the next generation, a will can be structured to retain the shares of a business in trust for one or more children. Alternatively, in the event the business will be transferred to a child during a parent's lifetime, either by gift or sale, one or more trusts can similarly be utilized to protect the business. In such cases, the asset will remain a separate asset, not subject to equitable distribution.

Whether any appreciation of a business held in trust is subject to equitable distribution will depend on the terms of the trust agreement and the specific rights bestowed upon the beneficiary vis-à-vis his or her ability to exercise control over the trust assets.

The potential downside to such a structure, however, is that the child will not have full ownership or control of the business—the trustee will. Thus, unless there is a trustee who the child gets along with extremely well and that the parent fully trusts, this option may not be feasible. Further, although this structure would be established for the child's benefit, he or she might be very upset at the restrictions entailed in such a setup. In the end, in order to avoid internal family conflicts, we generally advise clients to fully discuss the implementation of such a structure, explain the benefits to the child, and ideally have the child agree to the utilization of the trust as a mechanism to protect their future interest.

In the event that a child will be a passive shareholder in a business, the utilization of a trust may be ideal. Since the children will not be actively involved in the business, the asset and all income generated by such asset, as well as all appreciation, should be separate property (even if the terms of the trust vest the beneficiary with the right to receive assets from the trust). Of course, if the trustee makes a distribution to a child and he or she affirmatively commingles the money, then such money may be treated as marital property in the event of divorce.

When a business owner is contemplating a divorce, it is generally too late to engage in any techniques to protect their business. However, when individuals have the forethought to engage in premarital planning, and parents have the insight to have an estate plan, businesses can be well protected. ■

Naim D. Bulbulia, Esq., chairs the Trusts & Estates Department at Skoloff & Wolfe, P.C. Jonathan W. Wolfe, Esq., concentrates his practice on matrimonial law with a focus on complex financial disputes.