



Divorce and the Business Owner: Pre-Planning is Key

Lawyers and financial experts discuss the many ways to protect one's business assets.

By Eric C. Peterson, Contributing Writer

Divorce can be a long, expensive and painful process, but what if one of the spouses owns a small- or mid-sized business? How does that factor into the scenario? The experts weigh in on the impact and what can be done to protect those business assets.

Put bluntly, technically "it's against the law to do any divorce planning in New Jersey," says Victoria Tomaro, founder of V. Tomaro & Associates, a financial advisory firm in Wall. Still, there are ways to pre-plan and much of the onus falls on outside professionals. "You're going to have to hire a forensics accountant to look at the amount of income coming in from the business," she says.

"Pre-planning and understanding what the divorce process is all about can make it more reasonable and realistic for a business owner," says Mark Sobel, who chairs the family law practice group for Greenbaum Rowe Smith & Davis in Roseland. "For starters, a business owner needs to understand what is and isn't distributable under the laws of New Jersey, how we go about business valuation and equitable distribution, and how that may affect alimony payments and/or child support."

As in many legal matters, divorce overall can be “a timing issue,” says Jan L. Bernstein, who chairs the family law group for Riker Danzig in Morristown. “By the time someone is thinking about separating or divorcing, they’re probably already well into the business.”

“The first thing I tell any business owner contemplating divorce is go see a family lawyer,” Sobel advises. “You may do things innocuously, which may have dramatic effects on your case, and you as a business owner don’t even realize it.”

To begin with, “it depends on whether the business is a marital asset,” says Lori Roth, COO of the Basking Ridge office of the accounting firm Prager Metis. For example, if one did own a business prior to marriage, in the event of divorce “the only portion of that as a marital asset would be the change in the value of the business during the marriage.” Still, “it would be hard to keep it a totally separate asset because the income derived would be intermingled in their lives.”

The way the business is set up is important — sole-proprietorships can be problematic in divorce procedures, notes Carl J. Soranno, who chairs Brach Eichler family law practice in Roseland. Some alternatives: “If it’s an LLC, you want to have an operating agreement. If it’s a corporation, you want a shareholder’s or stock purchase agreement. In a partnership, you want a partnership agreement.

“In these agreements, you can structure provisions that protect the ownership interest from distribution to the spouse,” he says.

Those agreements should include buy-sell agreements that “define how someone gets bought out,” including in the event of a divorce, says Fred D’Arcangelo of Lindabury, McCormick, Estabrook & Cooper in Summit. “Most of those agreements have stock language that says, ‘We’re going to revalue

the business every year and we’re going to attach a document issued by our accountant that says what the business is worth.” For those that don’t have that clause, “in the context of a divorce, people with 20/20 hindsight would wish they had done that.

“It is also important to have something in writing that establishes the ownership interest of each partner,” he says.

“If a business owner has partners, it is important to have an iron-clad buy/sell agreement that addresses what happens in the event of a divorce,” concurs Scott Alters, senior vice president of Northeast Planning Corp., Cranford. For those without such a clause, “everything is fair game because the spouse can go after all the assets of

Carl J. Soranno:

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a business. If the clause is there, the partners can buy out the one partner who’s getting a divorce. The proceeds can be used to settle with the spouse, and the partner getting the divorce can buy back in at a later date.”

“Another strategy is an agreement that does not allow transfers to a non-business spouse,” says Henry Rinder of Smolin, Lupin & Co., CPA, in Fairfield. “The agreement itself prohibits the transfer of shares, member or partnership interests except to other partners.”

What if the business has locations in more than one state, or the business and residence are in different states?

“In my experience, the state in which the couple is domiciled provides the framework for the divorce,” says Rinder. “They may have assets all over the world, but the local jurisdiction’s laws normally apply. However, it gets tricky when you have people with

different residences; it really depends on who files first and how the courts view each other.”

“You certainly need an attorney on your side that either has a firm in multiple states or has good connections,” says Tom Bauman, director of equity sales for Northeast Planning Corp.

The Pre-Nuptial Agreement

One obvious step toward protecting one’s business asset is the pre-nuptial agreement. “It can define how that business is treated in the event of a divorce,” Soranno says. “It is a cost-effective, simple and practical way of protecting the asset.”

Pre-nup approaches include determining whether business interests will be separate property, defining whether marital income contributed to the business is a loan, and defining whether it is a separate piece of property. The latter is “problematic in New Jersey because any business has to be valued,” he says. “New Jersey is an equitable distribution state.”

“A pre-nup would certainly be a good start,” Bauman says. “As far as titling financial assets, if the couple has children or other individuals they want the assets to go to — as opposed to a spouse in the case of divorce — they can title those assets.”

And because some might not be comfortable asking for a pre-nup, they “can employ trusts as a means of excluding property,” Rinder says.

“The law generally says that the value of the business as of the date of marriage is exempt from distribution,” says D’Arcangelo. Children also come into play as they mature in a pre-nup because any interest they acquire in the future from the parent “would be exempt.”

If a business is acquired after the marriage, “entering a post-nuptial agreement has the same effect” as a pre-nup, according to Soranno. Re-



lated situations can include palimony agreements.

As to the actual divorce proceeding itself, “any asset acquired during the marriage is subject to distribution unless it’s a gift or inheritance from a third party,” Bernstein says. “New Jersey’s distribution statute has a number of different factors that a court would take into consideration in determining how the value of the business would be distributed.”

Those factors include everything from the parties involved, the partners, spousal participation in the business and more.

“Various percentages are assigned based on the judges’ evaluation of numerous factors — length of marriage, income and property each brought into the marriage, standard of living, eco-

nomie circumstances and pre- and post-nuptial agreements,” Rinder explains.

The bottom line is, “if you are trying to keep a business exempt from equitable business, it would have to be a pre-marital business,” Bernstein says. “Even then, the growth in that business could be considered marital, relating to appreciation accruing during the marriage.”

There are other possible options, however, including putting the business interests in trusts, Soranno says. “Some states, like Delaware, have what are called self-settled trusts, in which you can actually shield the asset from distribution.”

Distribution of business assets, when it does occur, also impacts alimony and child support. “It’s a process of ability to pay,” Sobel says. “If a busi-

ness is worth \$50 million and the wife is going to get \$20 million as her equitable share, she’s probably not going to need alimony.”

The basis for valuing a business comes into play, of course. “New Jersey is unique in that we have the case of *Brown v. Brown*, which basically says the standard of value, unless there’s extraordinary circumstances, is fair value, not fair market value,” Soranno notes. “That means you’re looking at the business without any sort of discounts that would normally apply in a business valuation.”

“The parties have to understand how the courts are going to go about evaluating the business, utilizing forensic accountants to evaluate the asset and come up with a value,” Sobel says.

When push comes to shove over

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distribution, “mediation works out well if the spouses can talk to each other and bring the information to the mediator honestly,” Tomaro says. “That can save lots of money in forensic and legal fees.” One caveat: “If both hire forensic accountants, they might get different valuations, and it will cost money anyway.”

In terms of personal assets in the divorce, “the more you keep property separate, the less likely it’s going to be considered marital property,” Soranno says. “Generally speaking, the best way to protect personal assets from distribution, particularly if they were earned prior to the marriage, is to treat those as separate property.”

Roth agrees, noting that such assets can be co-owned with other family members. He emphasizes, as well, that inheritances should be kept separate,

“but what can happen is if someone uses an inheritance to put an addition on their house, it’s no longer separate.”

“Did you use your inheritance to buy the business?” Tomaro asks. “If you did, and you didn’t commingle it with other funds from your house, then the business would be all yours.”

Ultimately, “the time to plan for divorce is not when you’re getting a divorce,” Soranno says. “It might be a little harsh, but in a business sense the time to plan for divorce is when you’re getting married or shortly afterward, or protect yourself throughout as you begin to acquire closely-held assets.

“You should consult with company accountants, advisors and legal counsel to have all corporate documents reviewed to make sure the company is protected, not only if you become in-

involved in a divorce, but also if any of your partners end up in a divorce scenario,” he says.

“Business owners typically have significant flexibility in how they’re running their business, but they need to understand the potential ramifications of their decisions,” Sobel says.

“If you own a business before marriage, a pre-nuptial agreement would definitely be a smart thing to do,” Alters re-emphasizes. “You should also have assets outside of the business – six months to a year of income in cash; all your protection and legal documents in place; and proper insurance, including umbrella liability policies to make sure you’re protected from lawsuits.

“The bottom line is that maintaining good records is key,” Tomaro concludes. *NJB*