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# Family law special report: Plan ahead and protect your assets

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Writing for Scottish Business Insider, Victoria Masterson investigates the legal issues for business owners when relationships turn sour

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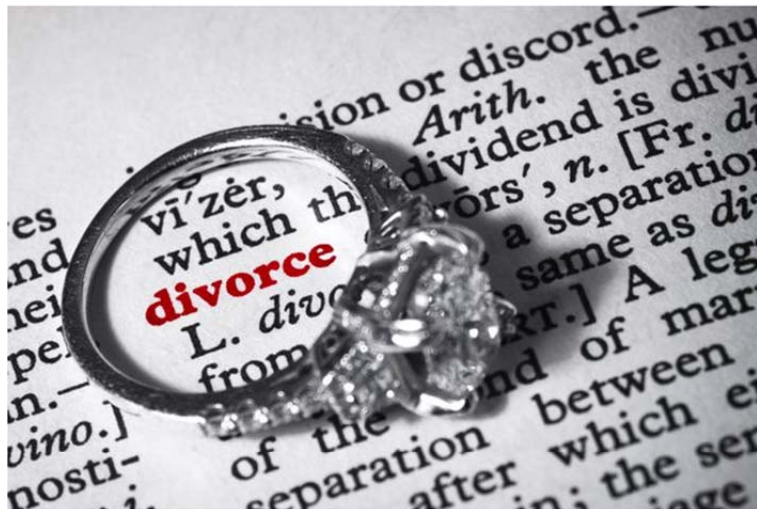
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RELATIONSHIPS can make or break a business.

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"Anybody who operates a business, whether it's a company or partnership, should pay attention to what is a fact of life – that relationships break down," says Fiona Sasan, a partner and accredited family law specialist at Morton Fraser in Glasgow and Edinburgh.

"It's still something of a dirty word to suggest things might go wrong, but it's important to take the sensible approach. You would protect yourself in many other areas of life, so why not protect your business interests?"

Pre-nuptial agreements and cohabitation agreements – legal agreements designed to set out how a couple would organise their affairs and divide their assets if the relationship were to end – are becoming increasingly prevalent, Sasan says, because they're generally regarded as being enforceable in Scotland, if they pass the test of being fair and reasonable at the time they were entered into.

Sasan explains: "If I'm worth half a billion pounds, is it fair and reasonable to ask my future spouse to relinquish their right to make a claim on any asset which derives from my pre-marriage wealth? Probably, yes – and this is where a pre-nup can help.

"On the other hand, would it be fair and reasonable if my future spouse doesn't share in wealth generated during the marriage? Probably not."

The key rule is a business or share owned before the marriage can't be counted as matrimonial property, divisible 50/50 between the parties.

However, this certainty can be inadvertently lost if the business is restructured.

"In my experience, lots of family-owned or owner-managed businesses come under pressure, either from their banks or on the recommendation of their accountant for tax reasons, to restructure their business," says Sasan.

"If you have owned your business or your shares in your business before you marry, these would not necessarily be shareable – unless you do some kind of share restructuring which causes them to fall into the definition of matrimonial property."

Cohabiting couples are equally exposed. A typical scenario might involve a couple moving in together where one already owns a business.

Their partner could then spend decades making a non-economic contribution to the success of the business, and make a claim accordingly.

"There's a myth that somehow there's a defined right that you can easily quantify the economic and non-economic contributions made in a cohabiting relationship," Sasan says.

"You have a right to make a claim, but there is nothing defined that can give you any certainty of outcome.

"It's a very dissatisfactory arrangement and that's why, again, a clear contract would provide some reassurance."

Sarah Tory, a financial adviser at Shepherd and Wedderburn Financial, says divorce is something that comes up increasingly in client conversations.

"Business and family wealth built up over generations is hard earned and lifetimes of careful planning can suffer if people don't consider what could happen in events such as divorce or separation," she says.

"Divorce is an unfortunate reality today and many clients are looking for solutions to preserve wealth – and put provisions in place should the worst happen.

"We protect our wealth in the event of serious ill health and premature death, and now increasingly people are looking at the more likely scenario of a break-up.

"The subject of divorce is now much less taboo, people are getting married later in life, and in many cases have more than one marriage in a lifetime. So it's natural wealth accumulated before the wedding itself is considered for the 'what ifs'."

Tory says the subject of pre-nups and cohabitation agreements is often introduced by families looking to make substantial gifts, either of capital or shares in a business.

"Rearranging the shares in a business in particular needs to be addressed carefully," she adds.

"The ramifications of a business exit through divorce can be devastating from a personal financial position and also the day-to-day running and profitability of a business."

Janice Jones, family law partner at Harper Macleod, is seeing more business people seeking pre-nuptial and cohabitation agreements and agrees business interests need to be protected from potential claims.

"Business owners should consider carefully, with their spouse or partner, their future plans in relation to things like having a family – who will take the childcare role and how should that be addressed?"

Jones adds. "This is particularly relevant where there are financial implications in terms of loss of career progression, loss of pension rights, as well as the obvious immediate loss of salary."

"Cases where the parties have approached the situation jointly to resolve it can be settled quite easily.

"However, we are seeing an increase in the number of cases where fairly unreasonable positions are being adopted by one party. People seem more combative and, despite the costs, prepared to embark on litigation."

If a couple work together and are both owners in the business, Jones recommends a partnership or shareholders agreement.

"Any involvement of the spouse or partner in the business, even as an employee, should be carefully thought through and documented," she says.

"Where a spouse is on the payroll of the other's business – and particularly where they actively work together on a day-to-day basis – the employment consequences can be wide ranging and the fact the couple are married is irrelevant.

"It's probably very tempting to simply sack a spouse at the end of a relationship – particularly if the business owner feels they've been wronged – but that will very rarely, if ever, provide an adequate defence at an employment tribunal."

Jennifer Wilkie, an associate in the family law team at Anderson Strathern, says there's an ethos in marriage about accumulating and sharing wealth, but it is a matter for both married and cohabiting couples to decide how they want to regulate their finances during the course of their relationship, and what will happen if the relationship ends.

"Nowadays separating couples not only appear to be switched on to the idea of sorting out their finances, but also to the psychological consequences of their relationship ending and, where there are children, how they continue to have a different type of relationship going forward.

After initial advice from a solicitor, couples are often happy to engage in direct discussions about how they resolve matters.

"The days of a financially naive side of the relationship are presented less, but in some cases there's still the significant hurdle to overcome of full disclosure by both sides of their finances.

"This can be particularly tricky where there's no longer trust or where one spouse has always been more financially savvy."

There are different types of dispute resolution in divorce cases which are being used more frequently in Scotland, Jones adds.

These include collaborative law, which operates as a series of meetings between the separated couple and their advisors.

Pensions and bonuses can also be counted as matrimonial property, regardless of whether the beneficiary has a stake in the business.

"A substantial pension accumulated during the marriage will form part of the matrimonial property, so it may be sensible to agree a pension-sharing arrangement to allow their spouse to share in the value of that pension," Jones suggests.

"A substantial bonus due to a person before the end of the marriage, but paid after separation, can lead to a difficult argument as to how that should be accounted for, depending on what period the bonus covers."

Charlie Burton, managing partner of Consilium Chartered Accountants in Glasgow, routinely advises people in business together – including couples and families – to have shareholder agreements, service agreements, financial powers of attorney, wills and shareholder protection such as key man insurance, to cover for the loss or incapacity of a key person.

"A proper suite of these arrangements deals with break-ups, incapacities and death," Burton says. "The issues are control, compensation and certainty."

"In other words, retaining control of the business, compensating the leaver, incapacitated person or family of the deceased – and knowing you're protected if the worst happens."

In the case of divorce or separation, it is better for the partners to agree arrangements while everyone is well and relationships are good – hence the need for a pre-nup or a post-nup, a contract that is written after the couple get married.

"A post-nup is the same sort of idea as a pre-nup, and just clarifies what should happen in the event of a split, for example that the family business is excluded from any claim," Burton adds.

"As it's not a pleasant thought, people often leave it until tomorrow – with disastrous consequences."

"I have visited the brain injuries unit to see a client after a road traffic accident who could never find the time to sign the draft will and power of attorney I had advised on with his solicitor."

"He survived for some months before sadly passing away and the effects on the business and family were exacerbated in the absence of the signed documents."

Cath Karlin, partner in the family law team at bto, believes it is vitally important to consider the impact of divorce on your business, particularly as around half of marriages end in divorce.

The statistics are similar for cohabiting couples, who have been able to make a financial claim on separation since the introduction of the Family Law (Scotland) Act 2006.

"When clients come to us it is often too late," Karlin says.

"Our job is to try to navigate them out of the mess. Sometimes we are unable to do so."

"In fact, some recent divorce cases have highlighted the need to take specialist advice before making major personal or business decisions."

Common pitfalls Karlin comes across include setting up a business with your spouse and your friend, and his or her spouse, where you each own 25 per cent of the

shareholding.

Transferring shares to a spouse or partner so the founder is no longer a majority shareholder is also very common.

To protect against potential fallout between significant shareholders, Karlin advises pre-nups for all those about to marry, separation agreements for those cohabiting or about to cohabit and post-nups for those already married.

"As well as the financial threat, there are other considerations a divorce action can bring, such as lack of privacy and the drain on business resources where much time and money is spent on complying with court orders for information.

"Add to that the loss of key staff for days on end when they are called upon as witnesses in the divorce case."

Ruth Aberdein, partner and head of family law at Aberdein Considine, sees many entrepreneurs failing to consider the possible implications of restructuring limited companies, for legitimate tax planning purposes, from a family law perspective.

"Many entrepreneurs gift shares in their companies to their spouses and appoint them as directors, often in order to optimise tax efficiencies.

"This can be prudent in many circumstances, but where a marriage subsequently breaks down, the smooth operation of the business can be negatively impacted as a result.

"The message is to take legal and accountancy advice before embarking on a restructure to ensure the possible consequences are fully understood and safeguards can be put in place."