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# Marriage, Divorce, & the Family Business: Protecting the Family Business from Divorce

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**One's ownership in a closely held business (often a family business) may be affected by a separation or divorce.**

In many situations, the business will be joined as a party in an equitable distribution lawsuit. "Equitable Distribution" is the term used in North Carolina for a lawsuit involving the division of marital property after a married couple separates. Once the business is a party to the lawsuit, it will need its own attorney – separate from the attorney for the spouse with the ownership interest.

In this article, we will discuss a number of the legal concepts and issues a closely held business should consider before selling, transferring, or gifting an interest in the business to a family member or any other third party.

## *There are three essential steps in any equitable distribution lawsuit: classification, valuation, and distribution.*

**Classification**
Initially, the Court (or the parties' respective attorneys) must determine what property might be subject to distribution. Property is a very broad term and includes LLC membership interests and shares in any corporation.

**"Marital property"** means all real and personal property acquired by *either spouse or both spouses* during the marriage and before the date of separation. Marital property includes, but is not limited to, ownership interests in businesses. Marital property is distributed between spouses in an action for equitable distribution.

If, during the marriage, a spouse acquires/purchases an interest in a closely held business (including a family business) and that acquisition does not come about by gift or inheritance, the interest will be classified as marital property, and the interest will have to be valued. *It does not matter that your spouse is not a legal owner of the business.*

**"Separate property"** means all real and personal property acquired by a spouse before the marriage or acquired by gift or inheritance during the marriage. Separate property is generally not distributed in an equitable distribution action, with exceptions as outlined in this article.

Business interests are often acquired before the marriage or acquired during the marriage by gift or inheritance, most often times from a parent. One might conclude that this business will be classified as separate property, and the spouse will not be entitled to any share of the business' value. Well, not so fast…

**How might a non-owning spouse acquire a marital interest in a business that is by definition the separate property of the recipient/owning spouse?** The most common answer is through the contribution of "funds, talent, or labor" of the marriage. *One or both spouses* may contribute marital funds to the business or work in the business during that marriage. To the extent the value of the business increases due to marital contributions or efforts, the increase in the business' value due to these contributions or efforts likely will be considered marital property.

Another way to analyze whether some component of a family business may be a marital asset is to consider an active/passive analysis. If the value increased passively (for example, through market factors or the labor of third parties) then the business will likely remain separate. If the value increased actively (for example, through the management or labor of *one or both spouses*), then there will likely be a marital component to the business.

While the concept that an increase in the value of a business resulting from the injection of marital funds, or from the labor of one or both spouse during the marriage, is reasonably easy to articulate, quantifying the increase is a far more difficult task.

**Valuation**
Quantifying the increase in value of a business due to marital contributions is a difficult task. The valuation process often requires one or both parties to retain a business valuation expert. In order for the expert to perform their analysis, it is likely the business will need to produce a significant amount of financial documents and other data. Presentation of credible evidence as to the value of the business is critical, and failure to present credible evidence could lead to an unfavorable value or the court's refusal to value and distribute the property.

**Distribution**
The final step of the process is to distribute the property.

**So how will the business be distributed?** If the ownership interest is a *marital* asset, then a Court could distribute the ownership interest to one spouse, both spouses, or, conceivably, to the spouse who previously had little or no involvement in the business.

The analysis becomes far more complex if the owning spouse acquired his/her ownership interest in the family business through gifts made to him/her by his/her parents, but he/she worked in the business and was the driving force behind the growth of the business throughout the marriage. Let's complicate it even further: the non-owning spouse also worked in the family business and is very familiar with the business operations. Could the Court distribute to the non-owning spouse an ownership interest in the business? It is possible.

## Proactive Steps to Protect the Family Business

First and foremost, **do not comingle/contribute marital property into a business that is otherwise your separate property**. It is also advisable to distance your spouse from a business that is otherwise your separate property. However, the most protective strategies to limit the exposure of a business in an equitable distribution action is through written agreements.

A **premarital agreement** is one option. A business owner may insist that any family member (or any other third party) who has an ownership interest in the business, or who might acquire a future interest, enter into a premarital agreement. This is far more common than one might expect.

If you or a family member (or any other third party) are already married, then a **post-marital agreement** is an option. For example, prior to transferring or gifting an ownership interest to a child or grandchild, one might require the married recipient of the transfer or gift to execute a post-marital agreement with the recipient's spouse. Again, this is far more common than one might expect. It is important to know that a premarital or post-marital agreement can simply address and protect a business interest, without more, if faced with opposition from the non-owning spouse.

A third option, which can be combined with either of the first two options, might be the **modification of the business's governing documents** so as to specify who may hold an ownership interest in the business, as well as certain buy-out provisions in the event of separation or divorce. However, if one utilizes only this third option, it does not eliminate consideration of the *value* of the spouse's ownership interest in the business as a part of the equitable distribution process.

It is important to understand that unless additional steps are taken, a thriving family business may experience unintended and disastrous consequences.

## Looking Forward: Federal Estate and Gift Tax Exemption to Sunset in 2025.

As a result of the Tax Cuts and Jobs Act of 2017, for the tax year 2025, a single taxpayer can claim a lifetime gift tax exemption of $13.99 million – for gifts made either during their lifetime or as part of their estate – without incurring federal gift or estate taxes. As a result of the same legislation, the exemption amount is set to sunset to earlier "base" levels in 2026. Unless the current law is extended or modified by Congress, the estate and gift tax exemption will drop to an estimated $7 million per person beginning on January 1, 2026.

Based on the gift and estate tax sunset, we anticipate an increase in the number of families attempting to transfer or gift to their children certain assets, including interests in family businesses.

It is crucial to consult with your estate planning attorney and financial advisors prior to making any such gifts in expectation of the sunset of the gift and estate tax exemption. Additionally, for the reasons provided in this article, an experienced family law attorney may be a crucial member of your advisory team. A parent/business owner should take appropriate protective measures when gifting to a child (or any other third party) an interest in the family business when that child or third party is married or anticipating marriage. A parent should also discuss with a family law attorney any involvement of their child's spouse in the business and how this may create a marital interest in a family business.



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