Healthy Profits, Sick Marriage: Estate Planning for the Separated Business Owner

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A business owner who is going through a marital separation understandably focuses on the property valuation and division issues inherent in separation and divorce. The owner naturally assumes that, as painful as the process may be, the owner will survive the separation and, with the help of a good family law attorney, will emerge with control and ownership of the business intact. Given human mortality, however, the owner also should not overlook or ignore the possibility that he or she may die during the separation period. Because the law provides a surviving spouse (even a separated spouse) with significant rights to a deceased spouse's estate, the business owner should modify the owner's estate plan as soon as possible after separation to minimize the impact that an untimely death would have on management and ownership of the business as well as remaining family. Among the steps that should be taken are the following:

Don't let your (Soon-to-be-Former) Spouse Become the Successor Manager of your Business

The separated business owner who fails to address estate planning issues unwittingly could make the soon-to-be ex-spouse the successor manager of the owner's business in the event of the owner's mental incapacity or death. To avoid this result, the owner should take several steps:

- Amend the owner's will to name a different executor. Married individuals often name their spouses as executors of their wills. Although divorce revokes such a designation, it remains in effect during separation (absent an agreement waiving that right). Accordingly, unless the owner amends the will to name a different executor, the owner's death effectively would place the separated spouse in charge of the business.
- Amend any existing durable general power of attorney naming the spouse as attorney-in-fact to name a new attorney-in-fact. Neither separation nor divorce revokes the designation of a spouse as attorney-in-fact, so the failure to change a power-of-attorney could give the spouse control of the owner's financial assets, including a business, if the owner becomes incapacitated.
- Address the "elective share." Although divorce will revoke the spouse's beneficial interest in the owner's estate, absent an enforceable agreement to waive such interests, separation does not. Further, even if the business owner's will is revised to remove the spouse as a beneficiary, the North Carolina Elective Share Act provides the spouse with the right to claim a certain minimum share of the owner's estate. This "elective share" is payable outright to the surviving spouse, so the owner's untimely death could have the effect of leaving a business interest directly to the surviving spouse. A simple way to avoid this result is to amend the owner's will to leave the minimum elective share in a qualifying marital trust for the benefit of the spouse, with a trustee selected by the owner controlling the assets used to fund that elective share trust.

Don't Make your Spouse an Unintended Beneficiary of your Assets

Without careful planning, there are several ways a spouse could receive more assets than required by law.

First, as mentioned above, the law provides a spouse with a minimum "elective share" of the separated spouse's estate until a property settlement agreement is signed that waives or modifies those rights. That minimum share, however, does not have to be distributed outright to the surviving spouse. It may be left in trust for the spouse so long as the trust meets certain criteria. A qualifying trust must have an independent trustee and must obligate the trustee to use income and principal of the trust for the spouse's health, support, and maintenance. But, absent significant and unexpected needs of the spouse (such as a catastrophic illness not covered by insurance), the bulk of the trust assets likely will remain intact and ultimately pass to the owner's selected beneficiaries (such as the owner's children) when the spouse dies.

One of the worst things a separated business owner can do is die without a will, or "intestate." If the owner dies intestate, statutes determine the percentage of the owner's estate that will go to the spouse, and the statutes presume a happy marriage. A well drafted will may lessen the share of the estate that may be claimed by the spouse. For example, if the owner is survived by a spouse from a second marriage and by two or more children from a prior marriage, the surviving spouse's intestate share of the estate is approximately one-third of the owner's estate. The North Carolina Elective Share Act, however, limits the spouse's share in such a case to only one-sixth of the owner's estate. Accordingly, a will that leaves the minimum elective share to the separated spouse effectively will cut the spouse's inheritance in half.

Unrelated to business considerations, the owner should be aware that under the North Carolina Intestate Succession Act, the owner's spouse is a potential heir of the couple's joint children. Accordingly, the design of the trust provisions for minor children could have the unintended effect of transferring assets to the separated, or even ex-, spouse in the event of a child's untimely death. Accordingly, the business owner's will should use only non vested trusts, which specify that the assets of the child's trust will go to recipients other than the spouse in the event the child predeceases termination of the trust.

Don't Forget that "Cash is King"

Business owners have a tendency to reinvest assets in the business, with the result that their estates often are highly illiquid. Accordingly, in the event the owner dies before the divorce is final, the surviving spouse's equitable distribution claim or elective share claim may have to be satisfied with ownership interests in the business. Assuming the business owner is insurable, this problem may be easily addressed through the acquisition of a substantial life insurance policy which will provide sufficient cash to satisfy the spouse's claims. Keep in mind that such insurance also will be helpful in satisfying obligations to another important, and equally cantankerous and demanding, claimant - the IRS. Estate taxes are due within nine months after death, and life insurance proceeds can provide the owner's estate with necessary liquidity to pay those taxes without selling assets or borrowing money. If the business owner already has life insurance policies, the beneficiaries on those policies should be changed immediately upon marital separation to ensure that the right person or entity receives the death proceeds. Neither separation nor divorce revokes the designation of a former spouse as the beneficiary under a life insurance policy; the policy owner must affirmatively change the beneficiary designation.

Protect your Children's Inheritance from Their Bad Marriages

A business owner undergoing a separation and divorce is living proof that approximately 50% of marriages end in divorce. Those odds are no different for the owner's children. Accordingly, if assets are left outright to the children, those assets ultimately may be subject to certain rights and claims of the poorly chosen spouses (not to mention claims arising out of lawsuits and bankruptcies). To protect the children from these worst-case scenarios, the business owner should consider leaving a child's inheritance in trust because the trust will shield those assets from spouses and other creditors. A well-drafted trust can give a child significant access to and control over the trust assets: not only may the child be the primary beneficiary, but the child also may be the trustee. Moreover, the child may be given control over the assets, such that the child may designate the ultimate recipients of the trust assets at the child's death.

A separation and divorce is an emotionally-trying experience. It, therefore, is natural for a separated business owner to focus on the immediate issues, such as property division and child custody, and it is difficult for the owner to add to the dreariness of the situation by contemplating the owner's own death. Nevertheless, the failure to address estate-planning issues immediately after separation from a spouse can have disastrous consequences in the event of the owner's untimely death. With careful planning and a few relatively simple steps, the business owner can minimize the impact of such an untimely death on the business and the owner's remaining loved ones.

For further information regarding the issues described above, please contact a member of the Trusts & Estates practice: Virginia Carter, John Cella, Eldridge Dodson, Zac Lamb, Gregory Peacock, John Sloan, Matt Thompson, or Peter von Stein.

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