

Businesses on divorce – is the tide turning?

Introduction

In recent years the impact of divorce on family businesses has been particularly damaging. More than ever, the courts have treated companies and their assets as part of the matrimonial pot. Business premises, directors' loan accounts, cash and income streams – all have been reallocated on divorce by the courts, often to the detriment to the business and its future. A recent case may signal that the pendulum is swinging back the other way. The purpose of this briefing is to highlight the risks to businesses, and what business owners (and their advisors) can do to limit the potential damage.

Divorced from reality?

To those used to the detailed constraints of commercial law – be it health and safety, employment, contract or company law – the free hand with which the divorce courts meddle can be something of a shock. On divorce, judges have complete discretion to reallocate assets and incomes, and this includes shares and interests in private companies. Where one spouse owns the business, the assets and income are as much part of the pot as the family home.

The courts do have guidance as to how to approach these cases – from statute and from previous cases in the higher courts. The interests of the business are weighed against the wider requirements of the family, but it should surprise nobody that that family courts may put greater emphasis on helping the wider family than simply what is good for the business.

There have been serious problems when judges have tried to divide the family wealth in business cases – especially when trying to leave each spouse with a roughly equal share. Here are some examples of what the courts have done:

- transfer the business premises to the other spouse who then receives a rental income;
- forcing a business owner to raise cash, either against his shares or against the business premises;
- ordering the sale of business premises;
- varying trusts which hold shares.

Third party involvement

The courts are less intrusive where other people share ownership of a business. They will be more careful not to prejudice their financial position. Instead they will look at the benefits which the divorcing spouse has drawn from the business historically, and look at what might be taken in the future.

Some of the most contentious cases arise in what are known as “alter ego” companies. Here the business owner may have involved other family members, effectively as nominees, while retaining control of the business himself or herself. Shareholdings may be put into trusts as a means of doing this. The family courts have historically been robust, treating these arrangements as nothing more than paper exercises. *“These arrangements fool nobody...”*

But perhaps the tide is now turning...

Hashem v Shayif

In a recent case, one family judge gave what is likely to be a influential decision in this area. In *Hashem v Shayif*, the husband had set up an offshore company to hold UK properties. He retained 30% of the shares, giving the

rest of the shares to his children by a previous marriage. He was also as obstructive as he could be in resisting his wife's claims! Surely an "alter ego" company, the wife argued?

No, held Munby J: the same law applies in family courts as it does in commercial courts. It is not possible to "pierce the corporate veil" and treat the assets as part of a matrimonial piggy bank unless there is impropriety. And that impropriety must be linked to the use of the company structure to avoid or conceal a liability.

If the court is to pierce the veil, it is necessary to show *both* control of the company by the wrongdoer *and* impropriety – that is, misuse of the company by the wrongdoer as a device or façade to conceal the wrongdoing. Significantly, trying to defeat a wife's claims is not a wrongdoing. Indeed, the corporate veil, cannot be pierced even if there is injustice to the wife as a result. The conditions about piercing the veil have to be strictly applied, whatever the consequences in the family courts.

Practical steps

What sensible steps can business owners and their advisors take – what can be done in practice to avoid criticism by the courts if a marriage fails, while looking to the future health of the business?

An obvious first step is to avoid sharing ownership of a business or company with one's wife or husband. The courts do look at the arrangements made during the marriage. If it was clearly the intention of both husband and wife that, for example, the husband was to be the sole owner of the business, then that will help on divorce. It will not be decisive, but everything should be done to avoid a wife being able to argue that she helped with the business, that she owned part of the business, or she was involved in the decision making.

Ensure that the company books and records show that the business interests are run independently. If all the assets have been moved around on the say-so of a husband, and if he has been allowed to treat the business as his own money box, then whatever arguments he puts to the contrary, a court will assume that he is going to continue to draw substantial benefits. However, if there are records to show that decisions have gone the other way within the company – that the longer term commercial interests have been preferred to the short term interests of the husband – then that will be valuable evidence.

If it is appropriate (and it is important not to put the legal cart before the horse), sharing ownership with wider family members will be helpful. The courts will be more careful to ensure that their interests will not be prejudiced, and the company and its assets will not be treated so readily as being "part of the pot".

Consider using a prenuptial and/or postnuptial agreement. In the recent case of *MacLeod*, the Privy Council significantly held that postnuptial agreements – agreements made after a marriage has taken place – will generally be treated as being binding on divorce. This is an important development in family law, and its full consequences are still being addressed.

Consider also wealth preservation structures such as family investment companies. These are being developed by Mills & Reeve as a means of passing wealth – and potentially businesses – down to future generations.