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How To Protect Against Losing Assets In A Divorce

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As authors of books on wealth protection for physicians since the 1990s, we have been asked hundreds of times by doctors about protecting assets in a divorce. This shouldn't come as a surprise, as over 50 percent of all marriages in this country end in divorce—and that percentage grows to almost 75 percent for second marriages. Doctors are not immune from this trend. In fact, the numbers for doctors may be even worse.

Thousands of physicians each year are frustrated with the financial consequences of their marital dissolution. They may not receive what they believe they deserve and lose personal assets intended for children or family assets intended to remain within the family, such as family businesses. While the loss of assets to a soon-to-be-ex can never be avoided, some of the financial pain of a split can be minimized with proper advance planning.

Examples of "Disaster Divorces"
The following are examples to help you consider whether you and your family are adequately prepared for divorce:

1. A couple marries, each for the second time, and each with adult children from a previous family. Without any pre- or post-marital agreement, they title many of the wife's previously separate income-producing properties (such as her rental apartment units) into the name of the new husband to save income taxes. Within two years of the marriage, they divorce. The husband gets half the rental units (in addition to alimony and other property), even though both spouses understood that the wife intended them to go to her children. The court simply ignored their understanding, giving half the properties to each spouse.

2. A couple marries, each for the first time. Over the next 20 years, the husband acquires more ownership in his family's bakery business. His father, the founder, gradually transferred shares to him. At 42, he is the majority owner. Unfortunately, he and his wife then undergo a bitter divorce with the ex-wife granted half the husband's bakery business as community property. She then forces (1) high dividends and (2) a sale of the company to a competitor.

3. An internal medicine resident gets married. She and her husband discuss her medical education and agree that she should not have to later compensate him for his greater financial contribution in their early years. However, they file for divorce eight years later. The husband considers the wife's professional degree as marital property, so he claims a share in her earning potential. The court agrees, even though the couple verbally agreed to the contrary.

Using a Pre-Marital Agreement
A premarital agreement (or, prenuptial agreement, premarital contract, ante-nuptial agreement, etc.) is the foundation of any protection in a divorce. The premarital agreement is a written contract between the intended spouses. It specifies the division of property and income upon divorce, including disposition of specific personal property, such as family heirlooms. It also states the responsibilities of each party and their children after divorce. Finally, these agreements lay out responsibilities during marriage, such as what each spouse can expect in financial support or which religion will be used to raise future children. The agreement cannot limit child support.

What a Pre-Marital Agreement Must Include
Each state differs slightly on what is required for an enforceable premarital agreement. Of course, you must get your state-specific advice from local family law counsel. But, for purposes of this article, generally:

1. The agreement must be in writing and signed.
Every state requires that a premarital agreement be written and signed. Many also require that it be notarized or witnessed.
TIP: *Notarize your agreement, even if your state does not require it. This adds protection against claims of duress or forgery.*

2. There must be a reasonable disclosure.
There must be a fair, accurate and reasonable disclosure of each party's financial condition.
TIP: *Attach financial statements to the agreement and have the spouse affirm knowledge of the other's financial condition.*

3. Each party must be advised by a separate attorney.
Many states either require separate legal advice explicitly or use it as a factor in determining whether or not the agreement was fair.
TIP: *Hire separate lawyers and give enough time between the agreement and the wedding to avoid any appearance of duress. Courts frown on last-second premarital agreements.*

4. The agreement must be unconscionable.
Courts will not enforce a one-sided agreement. Also, the contract must not be structured to encourage divorce. For example, by stating that one spouse has no rights to property except upon divorce.
TIP: *Avoid extremely one-sided agreements. It need not be a 50/50 split, but should provide a fair balance.*

5. The couple must follow the agreement during the marriage.
Courts disregard premarital agreements when the spouses blatantly disregarded it during their marriage, such as when property designated as the husband's separate property is re-titled to the wife.

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TIP: *Treat designated separate property as separate. If loans are made from one spouse's separate property to the marital unit, then those funds should not be commingled when repaid.*

Protecting Assets When You Are Already Married

Many physicians have contacted us about protecting assets when they foresee their marriage ending. Generally, there is not much one can do to shield assets if they are not already protected through a pre-nuptial agreement as above. However, all is not lost.

When implemented in a transaction with real economic substance (such as benefit, tax or estate planning), certain planning techniques may have a secondary benefit of lowering the value of an asset for marital dissolution purposes. This valuation benefit can end up being significant when the court eventually splits assets. We have seen this work quite successfully for physicians when investing in certain types of benefit plans through the practice, non-traded REITs and other temporarily-illiquid investments, specific types of cash value life insurance and annuities.

Example of Shielding Wealth through Valuation

Stan is a doctor who was in a rocky marriage. Stan implemented a non-qualified benefit plan at his practice and funded it over several years. While enjoying the income tax and asset protection benefits of the plan, he also chose an investment option that kept the plan value low for five years, after which it would quickly accelerate in value. When Stan ended up getting divorced three years later, this plan was valued in the divorce much less than it would have been if he had not used the plan design. Stan kept about $200,000 of value outside of the divorce decree because of this one tactic.

Conclusion: **Planning Here is Completely Fact-Specific**

Whether you are considering planning before you get married, after marriage, or even for a family member, no one tactic or approach works well for all clients. It is essential that you consult with advisors who are not only well-versed in family law, but also in asset protection – a combination that is much more difficult to find.

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