Danielle Friedman: Welcome to Trust Us Estate Planning Wisdom, the podcast where we unravel the complexities of estates and trusts to empower you with the knowledge needed for effective estate planning.

Max McCauley: This podcast is hosted by seasoned estates and trust attorneys, Danielle Friedman, Herb Feinberg, and

Herb Fineburg: Charles Max McCauley. This podcast is your guide to the intricate landscapes of estate planning, including wills, trusts, and probate.

Danielle Friedman: Thank you for joining us, and we hope you find the discussion informative. But remember, when it comes to legal matters, always consult with a qualified attorney regarding your specific case.

Herb Fineburg: I'd like to go over a case where we learned that even gifting small business interests should be in trust and shouldn't be outright to your children. This client owned a large rental company, and many years ago he gave a 1.5% interest to each one of his three adult children. He did not want to establish irrevocable trust for those interests, because he thought it would be too expensive. Later on, I convinced him when he gave away the rest of the company to give it into an irrevocable trust. But let's review what happened to the 1.5% interest that he gave to each of his children.

One of the children who was happily married when they made the gift, three years later came to him and said he was getting divorced from his spouse, and that 1.5% interest became a target of the divorce proceedings.

Danielle Friedman: Isn't it true though that if you receive a gift and you're married, it's your separate property? So when a child is divorcing, the parent could assume that, you know, this one and a half percent is not going to end up with their soon to be ex daughter-in-law because it stayed in son's name and he didn't commingle it with marital property. That's the case, correct?

Herb Fineburg: Yeah. I think the Jordan Law was going to get the 1.5%. That was always going to stay in the family, going to stay with the son. However, probably Max, it probably has some impact on the divorce proceedings because it's not only a division of property, some other things are going on in the divorce.

Max McCauley: Well, although

that should be the clear case with the 1.5% in a divorce or in any kind of litigation, there's always uncertainty. So when in the divorce they're valuing that interest, they very well might seek discovery into that value vis a vis obtaining tax returns or financial statements or bank account records.

Herb Fineburg: Their interest in the income also that is produced by that interest, because that impacts his ability to pay alimony, his ability to pay child support in addition to the value. So it's going to be, if he owns it outright, the court, which wears a divorce court, which wears a hat of equity, can ask those questions.

Danielle Friedman: And they're not just inquiring into Sun's one point five percent, they can look deeper into the finances of the company, look at loan documents, look at the tax returns, and information about the other partners in the company, including dad's financial information. So daughter-in-law is getting all of this data that could have otherwise been protected if the 1.5% was in trust, because it absolutely would not be part of the divorce proceeding.

Max McCauley: Yes, Danielle, it could be very intrusive and expensive.

Herb Fineburg: It's embarrassing to have your daughter-in-law know all your finances. When she didn't know it, the only reason she's getting to look at it is now she got divorced. The only reason it's becoming relevant is because he didn't give it in trust.

Danielle Friedman: So at the end of the day, Son got to keep his one and a half percent when the divorce was finalized, but it was counted against him in terms of calculating spousal support.

Herb Fineburg: Yeah.

Danielle Friedman: And then

Herb Fineburg: After divorce, that's when he gave him the other remaining interest in the business, which he did give it in trust. But as life would have it, son unfortunately passed away just a few years later, and his one point five percent he left to his surviving spouse. He had a, I love you, Will. He said, Everything I have goes to my surviving spouse. And she ended up getting the other 1.5% because it wasn't in this irrevocable trust.

Danielle Friedman: So he got remarried and he left the 1.5% to his second wife. And the wife became a partner in this business with her deceased husband's family.

Herb Fineburg: Yes. It was pretty much a shock to realize that they had a new partner, but that's what happened when they had given now right to the son and he wanted it to pass under his will to his wife.

Max McCauley: So it sounds like there are several concerns that could have been solved by using an irrevocable trust who would have addressed issues concerning divorce, lawsuits, creditor protection, and dad's desire to keep the business and the family bloodline.

Herb Fineburg: It's always a surprise of what passed. Where your children leave their assets, you can't control that.

Danielle Friedman: One question that comes up, this is really addressed to Max as the business attorney here. Could any of these problems have been addressed through the partnership agreement, whether it contained restrictions on transfer or some other terms? Not so much for the divorce proceeding, because I think they're kind of stuck, but for the second kind of issue that arose, which was the husband leaving the 1.5% to his second wife in his will. What, if anything, could the partnership agreement have done?

Max McCauley: You can eat away at the concerns. There's no substitute for using the irrevocable trust. But two things that come to the top of my mind would be, as you said, a transfer restriction or maybe put differently, a buy sell provision in the operating agreement or partnership agreement that says in an event of divorce, the company has the right to buy it back at a certain stated value or even a discounted value. You can address it that way. But secondly, as a matter of contract law, partnerships and operating agreements, excuse me, limited liability companies and partnerships are creatures of contract.

A fundamental tenet of the contract law is you can't force somebody to be a partner to a contract if the other parties don't agree. Now, that again doesn't solve the problem completely because although that spouse may not have the right to vote or participate in decisions, the court would certainly assign an economic value to the rights that were given to her. So you're still going to have to deal with that. So if you didn't buy that spouse outright, like what's the case here, again, the buy sell provision might help you. But the silver bullet, the concern that solves all of these would really be the use of the irrevocable trust.

So yes, from a business planning standpoint, from a business attorney standpoint, we can address it in part, but the better solution is to use the irrevocable trust.

Herb Fineburg: And in this situation, it would have been very important because each of the three children were actively involved in the business. They would have been getting one who passed away, The spouse wouldn't be working for the business, wouldn't be getting a salary. The other two would be getting a salary. Then the common problem is the surviving spouse asking, What is your salary?

Is that reasonable? Shouldn't we be paying more dividends? They become business partners. That is where the relationship starts to evolve or the family relationship starts to disintegrate.

Max McCauley: Good question, Danielle. The short answer to your question is yes, in part we can. As a business attorney, we can address these concerns with transfer restrictions and buy sell provisions, but the better solution is to use their irrevocable trust, and a more complete solution is to use their irrevocable trust.

Danielle Friedman: And how did things end with the wife? Did she end up being a partner, or did they buy her out? Or, you know, What happened to the 1.5% at the end of the day?

Herb Fineburg: Yeah, they didn't want her to be a partner, so they bought her out, they negotiated a price, she got what she wanted. It was of course unfortunate, it got nasty, she stopped talking to our client's son and daughter, and this also impacted our client's grandchildren. They stopped talking to each other because their mother was fighting with the family. So it resulted in a destruction of the family itself. Very powerful, unfortunate result when you don't do proper planning.

Danielle Friedman: It's really too bad that at the end of the day, this minor interest in this company that dad wanted to save a little bit of legal fees on and not put an irrevocable trust ended up being so disruptive through multiple major life events, and ultimately resulted in disintegration of these really important relationships. I mean, we think about trust as protecting assets from creditors and, you know, from other claims and just passing down wealth, but they also avoid these types of conflicts.\

Herb Fineburg: They preserve, in essence, they preserve family relationships. And those are the most valuable things that we think about when we think about our children and our grandchildren.