

# Pearlstein's Corner





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## What Small Business Owners Need to Know About Domestic Contracts to Protect Wealth

In January, Jeff Bezos announced that he and his wife, Mackenzie, will divorce after 25 years of marriage. Since the couple had no prenuptial agreement and Amazon was founded after they were married, Mackenzie was entitled to half of Bezos' 16% interest in Amazon. In their settlement, Mackenzie accepted 4% of the shares, with a total value of about \$35 billion.

From a business perspective, the Bezos divorce is actually fairly simple. Amazon is a public company and regardless of the size of Jeff's holdings, the company will carry on. But that's not the case in a private company where a small group of partners own the shares.

This is where two types of contracts are required to protect the wealth tied up in the business:

1. Personal contracts between each business partner and their spouse to address what would happen with the partner's company shares in the event of a divorce
2. A shareholders' agreement for the business partners that acknowledges the potential of a divorce for any partner and how that would affect share ownership

### The Odds of Marriage Breakdown are High

Statistically, the average marriage in Canada lasts 14 years. About 41% of marriages will end before their 30th anniversary. This has been fairly consistent since the 1980s.

Now consider that 80% of small businesses in Canada have no shareholders' agreement in place and those that do rarely address what happens to business assets in the event of a partner's divorce.

So, it's worth understanding the various types of agreements that may affect business partners at home or at work.

### Personal Contracts Have Various Names

Family law allows a couple to enter into a domestic contract that addresses how assets, income and support are to be divided should the relationship end, either by separation or by one of them passing away.



If this agreement is entered into before marriage, it's called a prenuptial agreement (prenup). If the couple is already married, it is a marriage contract, and if they are living together in a common-law relationship it is called a cohabitation agreement.

In effect and intent, they are all very similar.

### Critical Fact: An Agreement Must be Agreed Upon by Both Parties

It may sound obvious, but in order for an agreement to be valid, both parties must willingly agree to it. It cannot be imposed by one upon the other. And most importantly, it must be comprehensive.

A court may set aside all or part of a domestic contract due to non-disclosure of significant assets, debts or liabilities or the failure of one party to understand its nature and its consequences. Any hidden or undeclared assets could easily invalidate the agreement.

### One Goal of the Agreements Should be to Protect the Business

Of the three types of domestic agreements, a pre-nuptial agreement is theoretically the easiest. A couple that is not married or living together do not have any legal claim on each other's assets. Assuming they have an intent to live together, and are optimistic about their future, they should be able to come to terms on a prenup agreement. (This could be the first test of their marriage!)

It's a little trickier to initiate a marriage contract or cohabitation agreement, given that by family law, each partner has claim to 50% of the combined assets.

If one of the couple is a business partner, the agreement could state that the business shares will not be included in property division. This would likely mean that the business would be evaluated to determine the value of the shares and the division of other property would be adjusted to compensate for the fact that the shares are excluded from the agreement.

Ideally, each spouse would have their own legal representation to ensure that all questions are asked and answered. Better to get any issues out of the way now than face them later.

Perhaps the most difficult arrangement is when a business is formed during a marriage or common-law relationship, and both spouses play a role in it. In this case, the couple should enter into a shareholders' agreement which sets out the process by which a spouse would exit the business while the other spouse carries on with it, perhaps acquiring a partner to help operate it.

## When Business Partnerships Get Personal

Let's say you have a business with two other partners. All three partners are married. From a business perspective, it would be ideal if each partner had a similar domestic agreement with their spouse that protects the business while keeping the couples happy.

For some business partners, this could be an uncomfortable conversation to bring up if there is no existing agreement in place.

But here are some of the problems that could come up without personal agreements or a comprehensive shareholders' agreement:

- A spouse sues for divorce, demands half the partner's shares and to have a voice in the company.
- A spouse insists that the shares be sold to pay out the divorce settlement. They may not win in court but could create a long period of havoc, to say nothing of legal bills.
- A partner cannot raise enough cash outside of the shares of the company to satisfy a divorce settlement. Cashing out forces the other partners to buy back the shares, at what may be an inopportune time.
- Does the shareholders' agreement allow for a new partner to buy in? What does that process look like?
- Can a partner who is forced to cash out, still be an employee but not a shareholder?

These are all scenarios that can be alleviated with the proper agreements in place.

## Is Your Shareholders' Agreement Comprehensive Enough?

No agreement can anticipate or address all scenarios. However, given the statistics on marriage and divorce, it's worth reviewing your shareholders' agreement to ensure it adequately protects the company in case of a marital breakdown of one of the partners. The partners should acknowledge this possibility and be in broad agreement as to how they would proceed.

The first step in reviewing your agreements is to understand what's involved. That's where I can help. Although I am not a lawyer, I do have access to a highly experienced group of internal legal and accounting consultants. Our clients experience significant value surfacing when my team works with your legal and tax experts to develop optimal wealth planning solutions.

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Questions? I look forward to hearing from you.

Call me at 416-733-5257 or email [mark.pearlstein@rbc.com](mailto:mark.pearlstein@rbc.com)

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