

P+P Pöllath + Partners
Attorneys-at-Law | Tax Advisors

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A smiling couple in formal attire walking on a tarmac next to a small airplane. The woman is wearing a white dress and the man is wearing a dark suit. They are holding hands and looking towards the camera. The background shows the tail of a small white airplane and a cloudy sky.

Marriage and Divorce for Entrepreneurs and Managers

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Introduction

Marriage is not simply a legal transaction like any other. Primarily marriage is a very private matter. Nevertheless, entrepreneurs, managers and others with significant assets should not avoid taking the proprietary aspects of marriage into account. This brochure outlines the relevant proprietary questions arising from marriage and identifies economic risks that can be avoided through careful individual planning. The brochure also takes questions regarding taxes and international law into consideration.



Proprietary Aspects of Entering into Marriage

Legal Starting Point: The Community of Accrued Gains

In Germany, marriage does not lead to the spouses' properties becoming joint property. However, property acquired during the course of the marriage is subject to a certain degree of economic equalization when the marriage ends. Generally speaking, if the marriage ends, the spouse who has accrued fewer gains during the marriage receives an equalization claim amounting to half of the difference (= community of accrued gains).

Example: The spouses enter into marriage with initial assets of 1 M Euro each (value indexed). When the marriage ends, one spouse has accumulated assets amounting to 10 M Euro while the other spouse possesses assets of only 2 M Euro. The spouse with fewer assets then has an equalization claim against the other spouse in the amount of 4 M Euro (Calculation: $[10 \text{ M Euro} - 2 \text{ M Euro}] / 2 = 4 \text{ M Euro}$).

Marriage Contract as an Instrument for Asset Protection

For this reason, conclusion of a marriage contract before entering into marriage becomes an issue for entrepreneurs, managers and others with significant assets. Particularly, due to the fact that the equalization claim is due in money according to law, this can lead to forced sales, disclosure of hidden reserves or other financial disadvantages, depending on the

specific structure of assets. The idea of a marriage contract unfortunately still has a negative connotation and is often deemed unromantic, especially in Germany. Hence only one in four couples in Germany concludes a marriage contract before getting married. This aversion often turns out to be a mistake later, for example, when one spouse has a

significantly larger fortune or income than the other, or if one spouse expects significant increases in the value of his or her assets in the future. Articles of association often provide that the partners are obligated to conclude a marriage contract excluding participations in the corporation from the community

of accrued gains before entering into marriage. Similar provisions are common in contracts of donation and contracts of inheritance – here the donor or testator often demands that the donated or bequeathed property is secured by a marriage contract.

Marriage Contracts for Founders of New Business

Entrepreneurs whose businesses are still in the development phase should nevertheless consider a marriage contract. Take the example of a successful internet billionaire from the United States: He had married more than 20 years ago without concluding a marriage contract – this was before his future company had even been founded. By the time his marriage fell apart, he had built up an enormous fortune. According to applicable law (State of

Washington) the property accumulated during the marriage was to be divided equally. The German community of accrued gains would have led to a similar result. Luckily, the spouses in this case were able to reach an amicable agreement. Our experience shows, however, that this seems to be the exception. Oftentimes these cases lead to full-blown divorce battles that could have been prevented by a suitable marriage contract.

Conclusion

Entrepreneurs, managers and others with significant assets should carefully and matter-of-factly consider the proprietary consequences of marriage. The conclusion of a marriage contract may even eliminate potential conflicts and thereby allow for an unburdened beginning to the couple's future.



Content of the Marriage Contract

The marriage contract usually contains provisions regarding the following set of issues

Property Regime

The property regime of community of accrued gains can be modified by the marriage contract. Certain items can be excluded from the calculation. The equalization claim can be pre-agreed or capped. There is even the possibility to agree on complete separation of property which prevents any kind of equalization (Sec. 1414 German Civil Code / BGB). Assessment proceedings and payment arrangements can also be determined.

Note: The world of private equity especially calls for provisions regarding the different compensation structures. For example, some compensation structures (e. g., so-called carried interest) are difficult to assess or are subject to various restrictions (e. g., clawback) and are generally illiquid, so that the unrestricted consideration of these compensation structures in the equalization of accrued gains can lead to existential consequences for the affected manager.

Maintenance

Since 2009 the unwritten rule states that the economically weaker spouse may claim maintenance for a period of time equal to 1/4 to 1/3 of the duration of the marriage. In the upper income brackets, the amount of this maintenance claim is determined according to the actual marital standard of living

(**"specific needs"**). After the end of the period of regular maintenance claim there may remain a claim for compensation for disadvantages resulting from the marriage, like any infringement of a spouse's career.

The amount and duration of maintenance of the divorced spouse can be modified by the marriage contract. However, marriage contracts are subject to stricter judicial review since 2004. According to the **"legal rule regarding the inalienability of certain rights"** established by the German Federal High Court of Justice (BGH) excessive modifications, particularly with regard to maintenance, can lead to ineffectiveness of the entire marriage contract.

Note: This new adjudication regarding the ineffectiveness of marriage contracts also applies to contracts concluded before 2004. Existing contracts should therefore be reviewed to be sure they are up-to-date and should be amended if necessary.

Equalization of Pension Rights

Provisions regarding entitlements to a pension acquired during the course of a marriage are an additional component of a typical marriage contract. This may also include life insurance policies with a lump-sum option, depending on whether the option has been exercised before the divorce or not.

Note: The equalization of pension rights is often of minor economic importance for entrepreneurs due to the fact that they usually only acquire little to no such entitlements. Consequently, it may often be wise to refrain from modifying the equalization of pension rights.

Law of Succession

Marriage contracts can also include testamentary dispositions ("marriage and inheritance contract"). In order to provide mutual security, couples may consider providing for legacies or maintenance payments, which otherwise end in case of the death of one spouse. Furthermore, spouses may waive their entitlement to intestate succession or their

compulsory share. However, this option is rather irrelevant in the case of a divorce because the spouses' respective entitlement to intestate succession then ceases to exist. Testamentary dispositions only concern the termination of the marriage through the death of one spouse.



Special Case: Marriage Contracts in an International Marriage

International marriages pose special challenges for the composition of a marriage contract. Each legal system provides its own rules for the conclusion of marriage contracts. A marriage contract deemed effective under German law may not comply with the requirements of another country's laws (or vice versa). Thus, one must take all legal systems into account, to which an international family has connections, in order to compose a contract which adequately considers the special features of each legal system.

Proprietary Aspects in the course of the Marriage

Examples:

- **British law** is considerably stricter than German law with regard to contractual modifications to the consequences of marriage and divorce. A comprehensive judicial review of marriage contracts aims to determine a fair and just result.
- **French law** only allows a change of the property regime after entering into marriage if the statutory property regime has been in force for two years and the spouses can demonstrate a special family interest for the change to the property regime.
- **US law** differs from state to state. In most places, one can choose provisions similar to those in Germany. However, most states demand a detailed disclosure of the spouses' financial circumstances ("full disclosure") in order for the marriage contract to be effective.

Tax Liability for Benefits Granted between Spouses

The spouses are obligated to care for one another during the marriage. This tends to be misleading: Spouses think "**what's mine is yours**", imagining their property to be common property so that property can be freely transferred back and forth. This misunderstanding can lead to significant fiscal consequences and even criminal fiscal offences. For example, property transfers between spouses are subject to gift tax if these exceed the tax-free amount of 500,000 EUR per ten years (Sec. 16 (2) No. 1 German Inheritance Tax Law / ErbStG). The gift tax incurred on the exceeding amount can be between 7% and 30%, depending on the size of the granted benefit (Sec. 19 German Inheritance Tax Law / ErbStG).

If the granted benefits that exceed the inheritance tax-free amount are not reported to the local gift tax authority, the spouses may be prosecuted for tax evasion (Sec. 370 German Regulation of Taxation/ AO). This can even lead to prison sentences if the granted benefit is of very high value. Due to these significant consequences, spouses are strongly advised to seek out tax consultation in this regard before transferring substantial amounts of property.

Privileged Transfers of Property

The following transfers of property are privileged with regard to gift taxation:

Transfer of a Family Home

The transfer of the family home between spouses is generally free from gift taxation (Sec. 13 (1) No. 4a German Inheritance Tax Law / ErbStG). In case of the transfer of the family home inter vivos, no further requirements need to be met (in contrast to the transfer mortis causa, which generally requires the

continued use as a family home for ten years after the death of the transferring spouse, Sec. 13 (1) No. 4b German Inheritance Tax Law / ErbStG). The transfer of the family home can be combined with the reservation of the right of revocation in case of a divorce ("**lasso clause**").

Property Regime Swing

By changing the property regime from the community of accrued gains to the separation of property, an equalization claim can be produced. The fulfilment of this claim is not subject to gift tax (Sec. 5 (2) German Inheritance Tax Law / ErbStG). However, this payment does trigger income taxation so that hidden reserves are disclosed. Afterwards, the change of the

property regime can be reversed if the community of accrued gains is preferred (hence the name "property regime swing"). In contrast to the negative recent headlines concerning prominent cases, the property regime swing is a legal option which is unrightfully condemned as a "tax shelter scheme".



Occasional Gifts

Occasional gifts are not subject to gift tax as long as they stay within appropriate limits. What is **appropriate** in the specific case is determined by the respective lifestyle of the couple. An expensive wristwatch as a birthday present can be seen as a gift tax-free

occasional gift in one case and a benefit subject to gift tax in another. All in all, the tax authorities tend to be rather strict, even in regard to families with a strong financial background.

Proprietary Aspects Arising from the Termination of Marriage

Every marriage ends – either by divorce or by death. This topic is often disregarded in good times. Yet our comprehensive approach specifically includes guidance during the bad times. After all, the end of a marriage always involves an (involuntary) rearrangement of the existing property. Apart from the general issues of family law and law of succession, there are specific issues of company and tax law to be considered. International constellations create particular complexity.



Termination by Divorce

Divorce is not simply the termination of a contract, but a very personal life choice with great impact. Accordingly, German law requires the completion of a formal trial for a divorce to be effective. This often causes considerable stress for the parties involved. Therefore, we at P+P typically work towards reaching a mutual agreement.

Year of separation

In order to protect the spouses from precipitous decisions, German family law requires a mandatory separation period of one year. If this period has not yet elapsed, a divorce is only possible for important reasons like domestic violence (Sec. 1565 (2) German Civil Code / BGB). The year of separation begins when the spouses no longer share a common household and at least one spouse rejects conjugal cohabitation.

This requires a separation "of table and bed". While it is possible to live in separation in the same house or apartment (Sec. 1567 (1) Sentence 2 German Civil Code / BGB), this will often complicate proving the separation. Attempts at reconciliation during the year of separation do not interrupt or suspend the period of separation.

Judicial Proceedings

The marriage can be divorced by the competent family court after the year of separation. The territorial jurisdiction is generally based on the habitual residence of the spouses and their children. In the absence of a **habitual residence** in Germany, the territorial jurisdiction lies with the district court (Amtsgericht) Berlin Schöneberg if at least one spouse is German (Sec. 122 No. 7 Act on Proceedings in Family Matters and in Matters of non-contentious Jurisdiction / German FamFG).

Consequences of Divorce Agreement

The court will adjudicate on the consequences of the divorce if the motion to do so is brought forward, unless the spouses have already mutually agreed upon the consequences of the divorce. The conclusion of such a "consequences of divorce agreement" can prevent the divorce proceedings from turning into a legal battle or being carried out at the children's expense.

Typical Topics of the Agreement

- Amount of a possible equalization claim
- Amount, duration and payment arrangements regarding maintenance duties
- Execution of the equalization of pension rights
- Custody, contact and maintenance with regard to children
- Household objects and shared home

The conclusion of a consequences of divorce agreement may also be useful in order to eliminate doubts regarding the effectiveness of an earlier marriage contract or to modify provisions of the original marriage contract. **Note:** The consequences of divorce agreement as a special form of marriage contract must be notarized by a notary in the presence of both spouses.

Special Case: The Divorce of an International Marriage

International couples pose special challenges with regard to divorce. The question arises **where** the application for divorce can be filed. German courts see their territorial jurisdiction as given when one spouse is German or has his habitual residence in Germany (Sec. 98 Act on Proceedings in Family Matters and in Matters of non-contentious Jurisdiction / German FamFG). At the same time, a foreign court may also regard itself as having jurisdiction. In these cases, the possibility of "forum shopping" may be given; this means that the applicant can choose in which country he files his application for divorce.

This example shows what special challenges and also possible opportunities can arise in the divorce of an international marriage. Furthermore, a comparison of different legal systems shows considerable differences regarding the periods of separation, the principle of the breakdown of the marriage and length of proceedings. For example, Nevada allows an application for divorce after six weeks of residency, while Germany generally requires that the year of separation must have elapsed.

There is a well-known case of a German media star who had concluded a German marriage contract with his former wife. Before the divorce took place, the wife moved to the USA where she then filed for divorce. As a result, the local judge would have had to review the effectiveness of the German marriage contract. Although the couple ultimately reached a mutual agreement, this case became known among experts due to the possibility that the judge in the USA may very well have taken a different standing regarding the effectiveness of the marriage contract than his German colleague.

Termination by Death

The marriage automatically ends in the case of the death of one spouse. This leads to a combination of legal questions concerning marriage law and law of succession, but one must also consider company and tax law.

Legal provisions

The death of an asset holder generally leads to statutory succession. In the case of a **community of accrued gains**, the surviving spouse inherits 1/2, while the rest of the estate goes to the children of the deceased.

In the case of a **separation of property**, the division of the estate depends on how many children survive the deceased. In any case, multiple heirs form a community of heirs.

Testamentary Disposition

The testator himself can decide who is to be his heir or heirs. He can also bequeath individual objects to certain persons in the form of a legacy (e. g., real estate, a company or a stake in a company). This right is limited only by the rules regarding the **compulsory share**. Spouses may also make a joint will which must be written by one spouse and then signed by both.

Typically, spouses choose each other as respective heirs and their children as heirs to the longer-living spouse (so-called **"Berlin will"**). The Berlin will is generally better suited to smaller estates as it can lead to high inheritance taxation, due to the fact that two devolutions of an inheritance are necessary for the estate to reach the next generation. Larger estates therefore call for other solutions.

Tax Law

Inheritance tax law must generally be considered. Property transfers mortis causa are subject to the same rules regarding tax-free amounts as gifts (500,000 EUR per 10 years for spouses, 400,000 EUR per 10 years for children). The testamentary transfer of a family home is subject to special rules. It can be exempt from inheritance tax under stricter

conditions than the transfer inter vivos. The surviving spouse must continue using the family home as such for ten years after the death of the deceased unless urgent reasons (like illness) suggest otherwise (Sec. 13 (1) No. 4b German Inheritance Tax Law / ErbStG).

Company Law

If the deceased spouse held stakes in companies, the respective articles of association may have proprietary consequences. Often, articles of association limit the possibility of continuing the participation (e. g., by succession clauses, redemption rights

or caps on lump sum payments) or allow only the children of the deceased but not the surviving spouse to enter into succession. These specific characteristics must be considered in farsighted planning.

The P+P Consulting Approach

Thanks to our expertise in marriage law, law of succession, company law and tax law, we are able to offer comprehensive consultation on your marriage – for better and for worse.

The spectrum of our consultation covers, inter alia, the following topics:

- Strategic advice prior to marriage
- Conclusion and modification of marriage contracts
- Supervision of tax-advantageous property transfers during the marriage
- Implementing company law-related measures related to the marriage
- Conclusion of consequences of divorce agreements
- Conducting judicial divorce proceedings
- Handling the consequences of a divorce
- Consultation concerning law of succession prior to entering into marriage and in case of death





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