

Divorce & Dollars: Untangling Incentive Compensation

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Presenters



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Agenda

- Introduction
- Types of Executive Compensation
- Deferred Compensation
- Stock Options
- RSUs, PSUs – Oh my!
- Other Forms
- Case Study
- Wrap-up and Q&A

What Constitutes Income Per the Tax Code

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

- Compensation for services, including fees, commissions, fringe benefits and similar items
- Gross income derived from dealings in property
- Interest
- Rents
- Royalties
- Dividends
- Alimony and separate maintenance payments
- Annuities
- Income from life insurance and endowment contracts
- Pensions
- Income from discharge of indebtedness
- Distributive share of partnership gross income
- Income in respect of a decedent
- Income from an interest in an estate or trust

Other Forms of Income for Support

- Non-Taxable Income
- Deferred Compensation Plans
- Stock Options, Stock Grants, Other Share Based Comp
- Carried Interest
- Benefits
- Undistributed Profits or “Deferred” Profits
- Tax Free Exchange
- Cash Compensation
- In-Kind Services
- Gifts/Loans to Supplement Lifestyle
- Underemployment/Potential Income



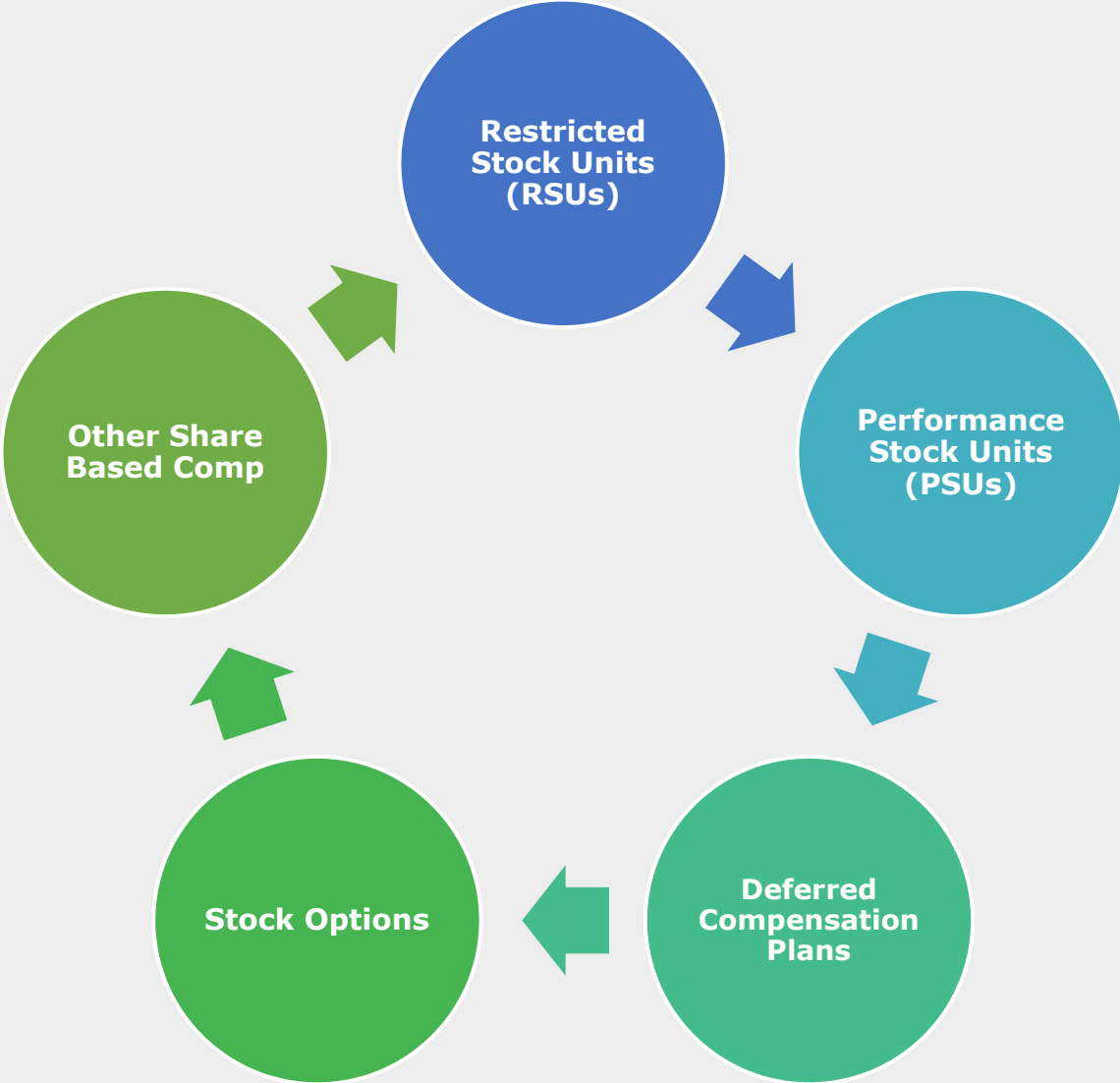
CPE & CLE Activity Question

How familiar are you with the topic we're discussing today?

- A. Very familiar**
- B. Somewhat familiar**
- C. Not very familiar**
- D. Not familiar at all**

Incentive Compensation

Compensation for Services



Deferred Compensation

- A portion of the employee's income is paid out at a later date than the date at which it was earned
- Non-qualified and qualified
- Pensions, retirement plans, employees stock options, etc.
- Qualified plans – comply with ERISA
 - 401(k), 403(b), 457(b)
 - Often an employer match
- Limits on annual amounts in a qualified plan. Highly compensation employees will have both
- Case consideration
 - Paystubs, W2s will list contributions which are not included in Line 7 – Salaries and Wages

Deferred Compensation

- Non-Qualified Plans
 - Wages are deferred and invested on employees behalf with a pre-specified point in time for receipt
 - Flexibility and discretion by the employer as to who participates
 - Pay tax on the deferred compensation at time eligible to receive not when received
 - Funded vs. not funded
 - Case considerations
 - Is it counted as income at time awarded or received?
- Other Deferred Comp
 - Employer-sponsored IRA, SEP
- May need a pension advisor if the plans are especially complex

Deferred Compensation – Case Considerations

- Be careful to confirm the contribution an employee makes to a qualified plan by reviewing paystubs or W-2 forms (Ref. the entry in Medicare box) of W-2. The pre-tax contribution to qualified plans is not included on Line 7 (Salaries/Wages/Tips, etc.) of the employee's 1040 U.S. Individual Tax Return.
- Consider when the compensation should be counted as income: at the time awarded or at the time received?
- Beneficiaries of deferred compensation generally argue that it cannot be counted as income until received because of the contingent nature of the compensation (Ref., i.e. the vesting schedule or requirements for continued employment.)
- It is possible that an intended beneficiary of non-qualified deferred compensation may not receive it or may receive it in an amount not contemplated or known at the time of a divorce. Thus, assess thoughtfully how to account for this benefit.
- Generally, it is safer to share it on an if, as and when received basis.



Stock Options

- A stock option is a privilege, sold by one party to another, which gives the buyer the right, but not the obligation, to buy or sell a stock at an agreed-upon price within a certain period of time
- Employee stock options:
 - Vest according to a schedule rather than a specific time to maturity
 - Service period between grant/vesting date (employment)
 - Grant price – represents FMV at the time of award

Stock Options

- Once vested an employee can exercise at “strike” price or keep the shares
- Often have an expiration date
- If stock is worth less at time of exercise than strike price, the option is worthless
 - Employee is not entitled to a tax loss in this situation
- Cash less exercise
- Case Consideration
 - Vesting schedules may have an impact on marital portion
 - Get the actual plan documents

Stock Options – Cashless Exercise

Step 1: Cashless Exercise

Vesting Date	Vesting Shares	Strike Price	W2 Comp	Price at Vest Date	Shares for WH @ 30%	Net Shares Deposited
12/31/21	1000	\$15	\$15,000	\$20	225	775
12/31/22	1000	\$15	\$15,000	\$25	180	820
12/31/23	1000	\$15	\$15,000	\$30	150	850

Step 2: Sell Shares

Vesting Date	Net Shares	Market Price	Basis	Gain Per Share	Total Gain
12/31/21	775	\$20	\$15	\$5	\$3,875
12/31/22	820	\$25	\$15	\$10	\$8,200
12/31/23	850	\$30	\$15	\$15	\$12,750

Stock Grants – RSU, PSU and Similar

- Grant stock to employees outright, with restrictions, contingent upon performance (“performance shares”) or contingent upon fulfillment of a service period
- Restricted stock awards
 - May be subject to forfeiture if the employee leaves
 - Subject to “clawback” if performance goals are not met
 - Cannot be readily sold and may be subject to “blackout” periods
 - Vesting schedule
- Case Consideration
 - Consider drafting language that appropriately treats replacement equity awards granted by a new employer for forfeited non-cash at a prior job

Stock Grants RSU, PSU – Cashless Vesting

Vesting Date	Vesting Shares	W2 Comp	Price at Vest Date	Shares for WH @ 30%	Net Shares Deposited
12/31/21	1000	\$20,000	\$20	300	700
12/31/22	1000	\$25,000	\$25	300	700
12/31/23	1000	\$30,000	\$30	300	700

Stock Grants – RSU, PSU and Similar

- Treatment in a divorce proceeding
 - Legal argument regarding treatment as income or as an asset
 - Separate v. marital
- Case Consideration
 - Consider drafting language to account for the vesting schedule and the unpredictability of the ultimate award amount
 - Consider drafting language that appropriately treats replacement equity awards granted by a new employer for forfeited non-cash at a prior job

Other Share Based Comp

- Stock appreciation rights (SAR) and phantom stock compensate an employee, sometimes without actual stock ownership
- Phantom stock is “cash-settled” so that the employee receives cash usually equal to the difference between the value of the company stock at the time of grant and the value of stock at the time of payment
- Can be paid in cash or shares
- Profit interests – equity compensation that are specific to limited liability companies
- Case Considerations
 - Whether compensation is awarded for past or future retention may impact how much is marital
 - Review plan documents

Carried Interest

- Share of the profits of an investment fund and is paid out long after it is earned to the fund's general partner(s) and investment managers
- Distribution of carried interest is often referred to as a "waterfall."
- Investment manager must return all capital contributed by investors before the carried interest is received
- Tax on carried interest is paid out at capital gains rate + 3.8% investment tax, payable to Medicare
- Case considerations
 - Ask your valuation expert whether he/she is considering carried interest in valuing property



CPE & CLE Activity Question

How do you prefer to engage during a webinar?

- A. Asking questions**
- B. Participating in polls**
- C. Joining breakout sessions**
- D. Chatting with other attendees**
- E. Watching and listening passively**

Case Study

Case Study – RSU Division

- Individual with 3 tranches of restricted stock units at least partially unvested as of the calculation date
- 3 year vesting period for all RSUs – vesting 1/3 in each of the 3 years
- Grant Dates
 - December 31, 2018 – 1,000 shares
 - December 31, 2019 – 2,000 shares
 - December 31, 2020 – 7,500 shares
- Determining separate property interest as of June 30, 2021

Case Study – RSU Division

Grant Date	Units Granted	Units Remaining as of 6/30/2021	Units Vesting Each Year	Vesting Date	Number of Years from Grant to Vesting	Years Vested as of 6/30/2021	Percentage Marital	Marital Units
12/31/2018	1,000	333	333	12/31/2021	3.00	2.50	83.2%	245
12/31/2019	2,000	1,333	667	12/31/2021	2.00	1.50	74.8%	395
12/31/2019			667	12/31/2022	3.00	1.50	49.9%	333
12/31/2020	7,500	7,500	2,500	12/31/2021	1.00	0.50	49.6%	908
12/31/2020			2,500	12/31/2022	2.00	0.50	24.8%	620
12/31/2020			2,500	12/31/2023	3.00	0.50	16.5%	413
	<u>10,500</u>	<u>9,167</u>						<u>2,915</u>

Case Study – RSU Division

Grant Date	Units Granted	Units Remaining as of 6/30/2021	Units Vesting Each Year	Vesting Date	Number of Years from Grant to Vesting	Years Vested as of 6/30/2021	Percentage Marital	Marital Units
12/31/2018	1,000	333	333	12/31/2021	3.00	2.50	83.2%	245
12/31/2019	2,000	1,333	667	12/31/2021	2.00	1.50	74.8%	395
12/31/2019			667	12/31/2022	3.00	1.50	49.9%	333
12/31/2020	7,500	7,500	2,500	12/31/2021	1.00	0.50	49.6%	908
12/31/2020			2,500	12/31/2022	2.00	0.50	24.8%	620
12/31/2020			2,500	12/31/2023	3.00	0.50	16.5%	413
	<u>10,500</u>	<u>9,167</u>						<u>2,915</u>

Case Study – PSU Division

- Individual with 4 tranches of performance stock units at least partially unvested as of the calculation date
- 3-year vesting period for all PSUs – not vesting until the end of the 3rd year
- Grant Dates
 - December 31, 2018 – 2,500 shares
 - December 31, 2019 – 3,000 shares
 - December 31, 2020 – 8,000 shares
 - March 30, 2021 – 12,000 shares
- Determining separate property interest as of June 30, 2021

Case Study – PSU Division

Grant Date	Units Granted	Units Remaining as of 6/31/21	Vesting Date	Number of Years from Grant to Vesting	Years Vested as of 6/30/21	Percentage Marital	Marital Units
12/31/2018	2,500	2,500	12/31/2021	3.00	2.50	83%	2,080
12/31/2019	3,000	3,000	12/31/2022	3.00	1.50	50%	1,497
12/31/2020	8,000	8,000	12/31/2023	3.00	0.50	17%	1,322
3/30/2021	12,000	12,000	3/30/2024	3.00	0.25	8%	1,007
	<u>25,500</u>	<u>25,500</u>					<u>5,907</u>

Case Study – PSU Division

Grant Date	Units Granted	Units Remaining as of 6/31/21	Vesting Date	Number of Years from Grant to Vesting	Years Vested as of 6/30/21	Percentage Marital	Marital Units
12/31/2018	2,500	2,500	12/31/2021	3.00	2.50	83%	2,080
12/31/2019	3,000	3,000	12/31/2022	3.00	1.50	50%	1,497
12/31/2020	8,000	8,000	12/31/2023	3.00	0.50	17%	1,322
3/30/2021	12,000	12,000	3/30/2024	3.00	0.25	8%	1,007
	25,500	25,500					5,907

Case Study – Options Division

- Individual with 6 tranches of options remaining as of June 30, 2021
- 3 year vesting period for all options – vesting 1/3 in each of the three years
- Grant Dates
 - December 31, 2014 – 2,500 shares
 - December 31, 2015 – 2,000 shares
 - December 31, 2016 – 2,000 shares
 - December 31, 2017 – 2,000 shares
 - December 31, 2018 – 6,000 shares
 - December 31, 2019 – 11,000 shares
- Determining separate property interest as of June 30, 2021

Case Study – Option Division

Grant Date	Grant Price	Options Granted	Options Remaining as of 6/30/21	Vested Options as of 6/30/21	Unvested Options as of 6/30/21
12/31/2014	\$ 39.81	2,500	1,000	1,000	-
12/31/2015	\$ 51.49	2,000	2,000	2,000	-
12/31/2016	\$ 71.43	2,000	2,000	2,000	-
12/31/2017	\$ 84.27	2,000	2,000	2,000	-
12/31/2018	\$ 83.19	6,000	6,000	4,000	2,000
12/31/2019	\$ 66.43	11,000	11,000	3,667	7,333
		25,500	24,000	14,667	9,333

Vesting Date	Expiration Date	Number of Years from Grant to Vesting	Years Vested as of 6/30/21	Percentage Marital	Marital Options
12/31/2017	12/31/2024	3.00	3.00	100%	1,000
12/31/2018	12/31/2025	3.00	3.00	100%	2,000
12/31/2019	12/31/2026	3.00	3.00	100%	2,000
12/31/2020	12/31/2027	3.00	3.00	100%	2,000
12/31/2021	12/31/2028	3.00	2.00	67%	5,332
12/31/2022	12/31/2029	3.00	1.00	33%	6,109
					18,441

Case Study – Option Division

Grant Date	Grant Price	Options		Unvested Options as of 6/30/21	
		Options Granted	Options Remaining as of 6/30/21		Vested Options as of 6/30/21
12/31/2014	\$ 39.81	2,500	1,000	1,000	-
12/31/2015	\$ 51.49	2,000	2,000	2,000	-
12/31/2016	\$ 71.43	2,000	2,000	2,000	-
12/31/2017	\$ 84.27	2,000	2,000	2,000	-
12/31/2018	\$ 83.19	6,000	6,000	4,000	2,000
12/31/2019	\$ 66.43	11,000	11,000	3,667	7,333
		25,500	24,000	14,667	9,333

Vesting Date	Expiration Date	Number of Years from Grant to Vesting	Years Vested as of 6/30/21	Percentage Marital	Marital Options
12/31/2017	12/31/2024	3.00	3.00	100%	1,000
12/31/2018	12/31/2025	3.00	3.00	100%	2,000
12/31/2019	12/31/2026	3.00	3.00	100%	2,000
12/31/2020	12/31/2027	3.00	3.00	100%	2,000
12/31/2021	12/31/2028	3.00	2.00	67%	5,332
12/31/2022	12/31/2029	3.00	1.00	33%	6,109
					18,441



CPE & CLE Activity Question

What time of day do you prefer to attend webinars?

- A. Morning**
- B. Early afternoon**
- C. Late afternoon**
- D. Evening**

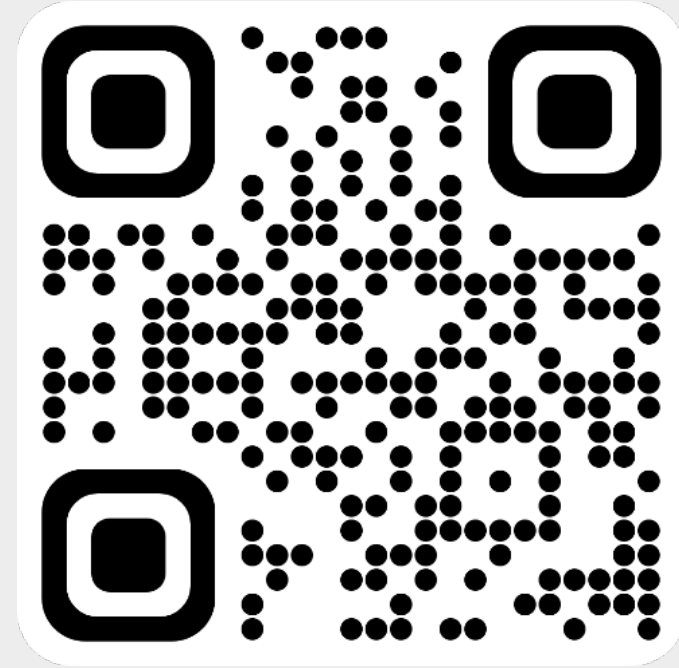
Questions



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