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What's fair in love and war: divorce in a volatile market

By Maria L. Remillard

After months of self-isolating, many marriages have reached their breaking point. Confined in an uncomfortable home environment while simultaneously juggling remote learning and employment responsibilities, some people do not want to wait until the pandemic is over to initiate divorce proceedings.

However, divorcing during a pandemic presents a variety of challenges that should be considered when crafting a settlement.

Emergency orders to curb the spread of COVID-19 and address the public health crisis have caused the closure of schools, businesses and the courts. The courts have valiantly struggled to address the enormous backlog of cases and new filings, while operating with limited staff at the physical courthouse. Hearings are being conducted telephonically and through Zoom to ensure the safety of court staff and the public.

Governmental measures taken to contain the spread of COVID-19 caused uncertainty in the financial markets and threatened the viability of many businesses. Since the unprecedented coronavirus hit the U.S. shores, it has created a wave of market volatility that is upending some divorce settlements and presenting challenges to divorcing high-income and high-net-worth couples.

Divorce was already a great disrupter of careful financial planning, but in the midst of a pandemic, it has shattered the security and futures of many.

Many couples have seen their wealth reduced, with businesses struggling, the stock market crashing, and no one knowing how long it will take for the economy to fully recover.

This has led to even greater challenges when valuing and dividing a divorcing couple's assets. For high-net-worth couples, the complex structure of their holdings consists of more variables than the standard divorce case, in which assets may be limited to the marital home and defined contribution plans.

In February 2020, a long bull market saw the Dow Jones Industrial Average reach over 29,570 points. Then, as the number of coronavirus cases began to increase and reports of shutdowns became prevalent, the market lost more than 11,000 points to reach a low of 18,321 points in mid-March. Faced with forced closures and stay at home orders, businesses saw an unprecedented decrease in revenue and reacted swiftly..

Not only did stocks lose value, reliable dividend-producing stocks suddenly halted or slashed dividend payments. Blue chip stalwarts such as Boeing, Ford, Delta, Dicks Sporting Goods and Marriott suspended all dividend payments. Others, such as Wells Fargo, reduced dividend payouts. Uncertainty arose over the viability of other stocks such as Hertz and J.C. Penney, both of which declared bankruptcy.

Interest rates have been viciously cut to stem the market freefall. As a result, people who hold trust interests, receive equity compensation, or rely on dividends or interest payments have seen their income take a nosedive.

Stock prices and valuations are now a moving target. Settlements that were premised on an equal division of the marital estate have suddenly transformed to a disproportionate division of assets due to the rapid decline of the securities.

To reduce the number of transfers, when dividing accounts, some couples will retain accounts of similar values at the time of their separation agreement. However, after the precipitous market drop, one account may perform significantly better than the other, resulting in the couple holding equities that are no longer equal in value.

While it would increase the number of transactions, one way to prevent a scenario such as that is to divide equally each trade lot of equities in kind, so each spouse bears the same market risk. Of course, in dividing the equities in kind, in which one spouse earns significantly more than the other, the tax impact of any liquidation of the stocks could also disrupt the equalization scheme.

Many high-net-worth individuals also have business interests that must be valued. With many businesses impacted by forced governmental closures and reduced revenues and demand, it creates uncertainty as to the viability of the holdings and the valuation. No one knows how long it would take for a business to attain pre-COVID levels of operations, or when or if a business could reopen without restrictions that have strangled revenues. There is also apprehension as to whether a business will survive. Conversely, businesses that have benefitted from the pandemic may not be able to sustain that growth as a vaccine becomes available.

Parties previously relied on valuations of appraisers hired to determine the fair value, yet those appraisals are based in large part on years of historical earnings in a stable market. If the business was valued prior to March 2020, the valuation would not take into consideration the unprecedented events occurring after the valuation date and assumed a continued, stable market.

Use of a well-versed business appraiser is imperative when structuring any settlement that values a business that one spouse will retain. Discounts and risk factors become more important than ever.

The use of the Paycheck Protection Plan must also be factored into the valuation, particularly if it is expected to be forgiven.

Attorneys can craft agreements to address the risk of valuations during this uncertain time, such as creating an interim holding arrangement or a look-back period. However, one should consider the actions of the business owner who may work seven days a week following the divorce to ensure the viability of the business.

The catastrophic impact of the pandemic is not only reflected in the valuation of the businesses and their reduced profits; the owners experience a corresponding reduction of personal income that impacts support obligations. It would be inequitable to saddle a business owner with a support obligation based on historical income if the business has been adversely impacted by the pandemic.

Some individuals considering divorce may determine that it is an ideal time to move forward to secure a favorable settlement, given the depressed valuations of property and reductions in revenue. Because property divisions are generally final and non-modifiable, care must be taken to mitigate the risks inherent in the current economic climate.

Real estate holdings that generate rental income, whether residential or commercial, may have been adversely impacted by the number of individuals and businesses that have been unable to pay rent.

Further compounding the issue is the inability to evict non-paying tenants due to the moratorium on evictions and foreclosures through at least this month. Arrears build up, but the prospect of recovering the monies are dim in many cases.

These turbulent times have also led to concerns about job security and reduced income, as some employers decrease compensation or suspend bonus payments in response to the declining revenues. With less income, a payor may be able to secure a lower support order, as support is traditionally based on current income.

Highly paid executives are not immune to the economic impact. An executive compensation package often consists of base salary, incentive payments, perquisites, benefits and equity compensation.

Equity grants are now worth a fraction of the value due to market volatility, which impacts either property division with respect to stock already received or support based on future grants. Stock options have been suddenly devalued or rendered worthless, as the value of the stock is sinking below the strike price.

Equity compensation often forms a large portion of the total compensation package upon which couples have historically relied. Instead of fixing a sum-certain support obligation that is based on past compensation, parties should share the risk and potential benefit of such equity compensation.

This could be achieved by assigning a percentage to be paid on all income, if as and when received, or setting a fixed support obligation on the base income and assigning a percentage to the variable compensation, with perhaps a ceiling to avoid a windfall to the recipient.

The tax ramifications of both property division and support must likewise be considered. If the individuals are in significantly different tax brackets, the after-tax value of the assets may produce an unintended disparate result.

Currently, for alimony orders issued after Dec. 31, 2018, alimony is not deductible to the payor at the federal level, so all payments are made with after-tax dollars. Assigning the statutory range of 30-35 percent of the gross difference in incomes could result in the payor receiving less money than the recipient.

With a looming presidential election, tax projections may change significantly. For example, Joe Biden's tax plan calls for an increase to individual tax rates for those earning over $400,000. All income over that threshold would be subject to a 12.4 percent Social Security tax.

Biden would remove the preferred long-term capital gains tax for households earning more than $1 million and impose taxes at ordinary income levels.

While it is impossible to predict the future, practitioners can craft divorce settlements that protect against some of the uncertainties in this turbulent economic climate.

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— Maria L. Remillard

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