

Must I share my future bonuses with my ex-spouse?

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With awards of annual bonuses for many fast approaching and predictions that bonuses in the banking sector this year will be high; this article considers how bonus payments are dealt with upon divorce and for how long after separation they might be shared with a former spouse or civil partner.

Bonuses

A common form of remuneration for many highly valued employees of established or start-up companies are deferred bonuses. These commonly comprise stock options or cash.

Bonuses can be discretionary or contractual; immediately payable or deferred.

Deferred bonuses are awarded based on an employee's performance in a particular year, but they are commonly paid three years later, to encourage the retention of the employee. (Unpaid bonuses are usually forfeited if an employee leaves the company).

Whilst over time the amount of a cash bonus might fluctuate in 'real' terms, the future value of a deferred stock scheme is far less predictable.

The two most common forms of deferred stock schemes which we come across regularly in family law are:

Stock options: where employees are offered shares at a particular price which vest on a certain future date (commonly in 3 years). These are typical arrangements of banks and other stock exchange listed corporations; and

Restricted Stock Units: (RSUs) where employees are granted a certain number of shares each year without any purchase. RSUs are increasingly popular with start-up and technology companies.

Upon stock options vesting, capital gains tax is payable on any gain. (This is more significant for RSU schemes as their initial value to the employee is zero).

Owing to their unpredictable value upon vesting, any distribution of bonuses in divorce proceedings should also be ordered to be paid on a percentage basis and net of tax.

Issues about bonuses upon divorce

Issues upon divorce include whether any deferred bonuses should be deemed:

- Capital to be shared as other marital assets; or
- Income to be shared as maintenance post separation

Over the past 20 years there has been considerable diversity in the family court's treatment of bonuses upon divorce.

Previous approaches to bonuses

- Upon Divorce Here is a summary of some approaches to bonuses adopted by the Family Court during the past 20 years:
- Bonuses awarded within 12 months post-separation should be '*readily shared*'
- Post-separation assets should not be '*shared*' at all after separation, (although the weaker financial party may be awarded an additional amount as maintenance to ease their transition to independence)
- Spouses should receive a decreasing percentage of bonus payments awarded post-separation (as well as any tailing-off deferred bonuses awarded during the marriage)
- There should be no distinction drawn between assets gained post separation to the date of trial, if the financial arrangements adopted by the parties had been '*a continuum*' of their financial arrangements prior to separation.
- Bonuses awarded post-separation should be used to top-up the other spouse's maintenance where it has been identified their reasonable income needs cannot be met from the spouse's basic salary; and particularly if bonuses have traditionally been relied upon to meet irregular or unexpected, but necessary payments. In doing so, the share of bonuses should be capped to meet the other party's assessed reasonable income needs.

With so many contradictory approaches about how bonuses should be treated, the division of bonuses frequently became a contentious issue for many families. So, what has changed?

The difference between sharing and needs, to meet the aim of financial independence

In English family law the principle for division of assets is that the paying party will pay to the weaker financial party the higher of:

- a) an equal share of the marital acquest (any assets accrued during seamless cohabitation and marriage) or
- b) sufficient to meet the weaker financial party's reasonable needs, factoring in the standard of living enjoyed during the marriage alongside affordability

A recent family court judgement has also determined that the clock stops for calculating the marital acquest at the date of trial, save in cases where there has been undue delay between separation and trial. This timing point should therefore be factored into any decision about determining the finances related to divorce, as for contentious matters, a trial date might not arise for over a year after the commencement of proceedings.

If sharing the marital assets equally meets both parties' future financial needs, the court makes a clean break order (i.e., an order where neither party can seek any more money from the other, in life or upon death).

Family judges are encouraged to achieve a clean break to enable financial independence for couples at the earliest date possible.

The Family Court's current approach to bonuses

There is now clear guidance that post-separation earnings (beyond the date of trial) should not be deemed assets to be 'shared'.

Therefore:

- Whilst bonuses awarded during the marriage should be deemed capital marital assets and be shared; bonuses awarded after separation (beyond the date of trial) should not be deemed to be capital marital assets and therefore

should not be shared.

- However, if the weaker financial party's future capital and income needs cannot be met by sharing half the marital assets, including deferred bonuses awarded during the marriage, then post separation income (including potential bonuses awarded post-separation) can be used to pay maintenance to the weaker financial party or as an additional lump sum to meet their future financial needs.

(The period of maintenance, including the years of bonuses to be used, will depend on when the receiving party can become financially independent).

Conclusion

The court's fundamental aim is to achieve a clean break for couples to achieve financial independence without undue hardship as soon as possible.

Consequently, unless the weaker financial party's future financial needs for capital and income cannot be met by sharing the marital assets upon separation, bonuses awarded post-separation (from the date of any trial) should not be shared.

However, those bonuses which were awarded during the marriage but are yet to vest (including those to the conclusion of any final financial order) will be deemed marital assets for sharing.

Another related consideration when negotiating is to be mindful of sharing the risk/liquidity associated with various assets. For example, if too much of the safer capital, like cash savings, is paid in lieu of any share of deferred bonuses, it is important to be aware that the value of deferred bonuses can fall or be lost altogether if the relevant employee leaves. Once a final financial order is made it is purposefully very difficult to revisit the order's fundamental terms. Consequently, assessing the risk structure of any draft final order as well as the overall quantum should be considered carefully.

*Issues mentioned in this article relate equally to the dissolution of civil partnerships.

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