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When 'If and When' Becomes 'Here and Now'

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Deconstructing Deferred Compensation, Deferred Stock Options and Deferred Stock Bonus Plans. Part One of a Two-Part Article

In these troubled economic times, many companies are dissolving or merging to survive. Mergers can present some difficult issues to matrimonial attorneys. A discussion of one such merger, pharmaceutical company Wyeth, will illustrate some of the problems and their resolutions. In addition, several sample forms follow this article.

The Wyeth Merger

On Oct. 15, 2009, Wyeth merged into Pfizer, another pharmaceutical manufacturer. Understanding the various deferred compensation plans at Wyeth before October 2009, was an education in itself. The acquisition of Wyeth by Pfizer shifted the treatment of certain deferred assets to accelerate the liquidity of assets in some cases, but not in others. Depending upon the type of plan and the decisions made during the merger, some equitable distribution problems were solved and other problems were created regarding equitable distribution of deferred assets. Deconstructing each category of assets and the impact of the merger illustrates how novel assets require foresight — and a crystal ball — to protect the non-employee spouse.

Deferred Compensation

A Wyeth employee who qualified for deferred compensation presented a pay stub showing salary allocated between a monthly salary and an annual performance incentive award (bonus). The deductions included the typical insurance costs, and various federal, state and local taxes. In addition, there was a pre-tax deduction for both deferred salary and deferred performance incentive award. Since those deferrals represented 10% of the gross income, they significantly reduced the employee's cash flow, and federal taxes. In the year of separation, the analysis of income available for support was reduced in order to preserve the non-employee spouse's claim to deferred income and the performance incentive award attributed to the marital year, to be treated as marital savings. In the year after separation, the deferral of post-separation salary and performance award by the employed spouse was voluntary. Therefore, income available for support was based on full salary and bonus, less theoretical taxes. If the employee reversed the election for future income, in order to improve cash flow, such cash flow would improve to pay child support, (and spousal support if applicable), but the employee would forfeit the opportunity to shelter income from federal tax.

The Wyeth deferral plans allowed an employee to delay the impact of income in several categories: compensation and bonus (in the form of performance incentive award), and in three different stock plans, which will be discussed below. At the time of negotiating the divorce settlement, it was recognized that the income that had been deferred from prior years had been earned during the marriage. Under Pennsylvania law, such deferred income qualified as a marital asset to the extent it was attributed to employment prior to the date of separation. Since deferral was year by year, and the income deferral extended ten or more years, the Property Settlement Agreement needed to contemplate reservation of the non-employee's interest in the deferred income from the marital years.

The employed spouse's counsel focused on two issues: deferred income and deferred taxes. Because the income was deferred in order to get delayed federal tax treatment, the employed spouse needed assurance that the non-employed spouse would receive the share of the after-tax benefit, rather than a claim to the pre-tax dollars. Meanwhile, the non-employed spouse had a lower tax rate, and, therefore, wanted to avoid attribution of more taxable income than necessary. One solution would be to stipulate to an amount of alimony based on a percentage of the gross deferred salary and bonus. This would allow the shift of the gross payment from the employee to the non-employee, allowing the employed spouse to deduct the entire deferral as an alimony payment, and the non-employed spouse to include this in income and pay taxes at the non-employee's rate.

Benefit v. Protection

The theoretical benefit of the alimony payment must be balanced against the protection available to the non-employed spouse. If the non-employed spouse dies before the deferred payout, the alimony is forfeited to protect deductibility. When you have an alimony payment on deferred distribution of income or assets, and a shift from the pre- and post-merger employer, communication with all of the employer's benefits administrators is critical. In anticipation of the merger, special drafting and authorizations signed by the employed spouse were required.

Wyeth developed various deferred compensation plans, and at the date of separation there were three different plans relating to the particular employee. One plan allowed for a ten-year deferred payout. A second plan allowed for deferred income until "normal retirement," deferred until the employee was due to reach age 65. A third account, deferred until actual retirement, allowed for ongoing compensation contributions, some of which occurred before separation as well as additional contributions post-separation. Therefore, for the third deferred income account, at the time of distribution a marital percentage would be calculated based on the contributions during the marriage, divided by total contributions.

Under the terms of the deferred compensation plans, not only was the employee's income deferred and subject to federal taxes at the time of distribution, but the funds deferred would be invested on behalf of the employee, so the ultimate distribution would include not only income, but passive growth and the risk of decline.

The Non-Employee Spouse

In order to provide some protection for the non-employee spouse, the employee agreed to name the former spouse as death beneficiary of a portion of the deferred compensation plans, as well as a beneficiary of life insurance until deferred compensation payments. Recognizing this protection may be in excess of the non-employee spouse's claims, the non-employee spouse agreed that any excess benefit would be gifted to the parties' children.

In terms of protecting the non-employee spouse's ability to communicate with both the employer and the successor employer, a detailed Release and Authorization was signed by the employed spouse. Authorizations to the benefits administrator at Wyeth needed to be transferable to the benefits administrator at Pfizer. Three Release and Authorization forms were signed because three departments handled deferred compensation, deferred stock and incentive awards, and management of deferred investments. In addition to the Wyeth payroll department, there was a consulting company and a stock account administrator.

Another consideration was the long-term involvement of the former spouse, who may not want to pay a lawyer's hourly rate to monitor deferred income that is locked for 10 to 15 years in deferred accounts. Accordingly, the Releases allowed for inquiries by the former spouse, attorney for the former spouse, and financial advisor for the former spouse.

Performance Share Awards

In addition to the employee being allowed to defer income and bonus (performance incentive award), Wyeth had a long-term incentive program that provided for performance share awards of Wyeth stock. Every year the company would grant to the employee a certain number of units of stock that would be adjusted up or down based on the performance of the entire company at some future point in time. For example, in the spring of 2005, Wyeth provided a target award for the benefit of the employee, based on a formula to adjust that award upward or downward, depending on the performance of the company in 2007. The 2007 performance would be assessed in February 2008. At the time of the finalization of the divorce settlement in 2008, that performance adjustment for 2007 had been assessed, and 560 units were adjusted upward so the employee received 116.8% times 560 units for a total of 654 units. Back in 2005, the employee also opted to defer receipt of the units for a fixed number of years. Obviously, if the non-employee spouse had only reserved a claim to the 560 units awarded in 2005, he or she would have received less than what arguably were the marital shares.

The court award was for a percentage of the adjusted units, rather than a percentage of the original award. In each successive year, the employee was granted another target award subject to prospective adjustment. As a result of the merger, the performance share award immediately prior to the merger was paid to the employees without adjustment. The earlier performance share awards, no longer subject to adjustment, resulted in a deferred award at the election of the employee. The non-employee spouse must wait until the deferral date, and the amount of the share award will remain unadjusted due to the fact that Wyeth's performance is no longer a factor.

At the time of negotiating the divorce settlement, since the award was based on the performance of the company post-separation, the court granted the non-employee spouse a declining percentage interest in the awards. The settlement terms specifically provided that there would be supplemental life insurance to protect the non-employee spouse's claim to the performance share awards. The divorce settlement also prohibited further deferral of awards.

Conclusion

The conclusion of this article will discuss options, but the issues discussed above are not as unusual or arcane as they might, at first glance, appear. Mergers are becoming more frequent in the current economic climate and matrimonial practitioners might soon be faced with deconstructing deferred compensation, stock options and bonus plans. Below are the deferred compensation clause and one of the Releases.

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DEFERRED COMPENSATION DISTRIBUTION

Wife is a participant in the Wyeth Deferred Compensation Plan. The company currently administering the Plan is XXXXX Consulting. Due to prior election to defer compensation and performance incentive awards, Wife had $XX,XXX as of 10/17/07 in the Plan in three different distribution accounts. The account to be distributed as of the first quarter of 2017 had assets valued at $XX,XXX, as of 10/12/07. It is agreed that this First Quarter 2017 Distribution Account is entirely marital (no future contributions will be made) and Husband's claim is to 60% of this account value at time of distribution, which will include any passive growth or decline in the assets invested therein.

Wife also had assets in the Lump Sum at Normal Retirement Distribution Account, valued at $XX,XXX, which account is entirely marital (no future contributions will be made) and Husband's claim is to 60% of the account value at the time of distribution, just following Wife's normal retirement at age 65, April 22, 2025, which will include any passive growth or decline in the assets invested therein.

The Distribution Account into which additional compensation can be contributed is the One Payment at Retirement Distribution Account which had $XX,XXX as of (DATE). There will be (and have been) post-separation contributions to this account to which Husband has no claim. At time of distribution Husband's claim is 60% of the marital share. If Wife cannot prove the growth or decline in the value of those investments from (DATE) until the distribution, a marital quotient will be used (number of pre-separation months married and working at Wyeth divided by number of months working at Wyeth) to determine the marital share and Husband will receive 60% of the marital share.

All distribution to Husband shall either be made by Wyeth, or if that is not possible, made by Wife within two weeks of receipt of her distribution. Wife shall provide Husband with all paperwork received so he can confirm the correct amount due to Husband.

It is acknowledged that Wife will need to calculate her tax liability on these Deferred Compensation distributions. Husband's distribution should be based on the distribution net of taxes. Initially, Husband will receive 60% of the marital assets net of the tax withholding by Wyeth. Wife will provide Husband with her federal tax returns (within two weeks of filing) for the years of distribution and if her blended tax rate is less than the withholding, Wife will pay Husband amount over-withheld for taxes. If the taxes are in excess of withholding, Husband will pay Wife the difference. Tax payments are due within 30 days of written notice.

Wife agrees to name Husband as beneficiary of $XX,XXX of insurance on her life until he receives all his Defined Compensation Payments. Wife will name Husband 60% beneficiary of the entire Deferred Compensation Plan, which beneficiary designation will be irrevocable and if payment is made to Husband in excess of his equitable distribution share, Husband will give the excess amount to the parties' children, one half to each.

Wife will sign all authorizations or documents required by Wyeth or the Plan Administrator to authorize Husband to receive information regarding the Defined Compensation Plan including Husband shall receive notice in the event Wife is terminated prior to 2017 retirement which will trigger immediate distributions to Wife. Wife's authorizations will also allow Husband's designated financial advisor to inquire as to the status of the Wife's Deferred Compensation Plans. Husband at his option may seek a Court Order from Berks County under the divorce action directing Wyeth and the Plan Administrator of the Defined Compensation Plan to make the distribution of Husband's share of the marital assets as outlined above. Wife will sign any stipulation required to facilitate this.

RELEASE AND AUTHORIZATION

Wyeth Long-Term Incentive Program Department

ATTENTION:

E-mail:

RE: (EMPLOYEE NAME), Social

Security No.

E-mail:

I, (EMPLOYEE NAME), hereby authorize my employer, hereinafter "Wyeth" and specifically the Long Term Incentive Program Department, to release any information regarding my compensation, bonuses, retirement plans, retirement savings, deferred compensation and any other aspect of my income or accumulated benefits through 2007. In addition, information should be released after 2007 if it relates to benefits that were acquired through October, 2007, or if the savings, benefit or program has been replaced by Wyeth or its successor in replacement of those Wyeth benefits and plans.

This Authorization specifically includes disclosure regarding the 2007 Performance Incentive Awards, including deferred receipt of those awards; it includes deferred compensation earned for the calendar year 2007, and prior years (but not subsequent years), including accelerated distribution of the deferred compensation plans in existence in 2007; the Release extends to my interest in any and all retirement accounts and savings accounts for my benefit as of 2007, including conversion of those accounts to a different program after 2007; the Release extends to all stock plans, including the Wyeth Stock Incentive Plan, the long-term incentive program, Performance Share Units and/or Performance Share Awards, Restricted Stock Units and/or Restricted Share Units; and Wyeth Stock Options as of 2007, including information regarding any benefits or plans that are designed to replace the above programs or plans.

This Release authorizes you to provide information requested by the following persons:

My ex-spouse, (NAME); current address (ADDRESS); e-mail:

My ex-spouse's attorney, (NAME), Esquire; (FIRM), ADDRESS, e-mail:;

The designated financial adviser identified by my ex-spouse, (NAME), which designation should be in writing.

At any time information is provided to my ex-spouse, the attorney or the designated financial adviser, the same information shall be released to my attorney, (NAME), Esquire, FIRM (NAME), ADDRESS, e-mail: .

This Release shall expire at a date in the future once all assets or claims by my spouse, (NAME), have been satisfied under the terms of our Property Settlement Agreement. A copy of our Property Settlement Agreement will be provided with this Release. It is contemplated that I will sign a replacement Release if Wyeth is acquired by another company, and the successor company takes responsibility for the Wyeth Plans and Programs, or provides a substitute Plan or Program. You are requested to advise my ex-spouse and counsel in the event that Wyeth is not the proper person to contact at any time in the future prior to the satisfaction of all claims under the Property Settlement Agreement. I will notify you, (with a copy to my ex-spouse and attorney), when this Release and Authorization is due to expire under the terms of our Property Settlement Agreement.

DATE (EMPLOYEE)

Below is the clause describing distribution of the Performance Share Awards.

PERFORMANCE SHARE AWARD DISTRIBUTION

The parties acknowledge that Wife's employer, Wyeth, has a Long Term Incentive Program which includes the Performance Share Awards (PSAs) granted to Wife during the parties' marriage. Attached hereto as Exhibit ______ is the PSA Award History as of 10/17/07 (also Tab 21 of Wife's disclosure to the Divorce Master.)

The 4/21/05 PSA granted a target award of 560 units based on performance year 2007. The 2007 year was reviewed by the company in February 2008 and resulted in a performance adjustment of 116.8%, so Wife's adjusted 4/21/05 award is 654.08 shares. Wife elected to defer receipt of these shares for three years which are now held in trust for three years, presumably until 2011 (for which the deferral date needs to be provided by Wife or Wyeth). At such time that the 4/21/05 PSA Units are available for distribution, Husband shall receive 60% of the adjusted units, net of taxes as described below.

The 4/27/06 PSA granted a target award of 530 units based on performance year 2008, which will soon be reviewed by the company. Wife shall authorize Wyeth to disclose to Husband the 2008 performance adjustment so Husband is aware of the adjusted 4/27/06 award. Wife elected to defer receipt of these shares for three years which shares will be held in trust presumably until 2012. (The deferral date needs to be provided by Wife or Wyeth). At such time that the 4/27/06 PSA Units are available for distribution, Husband shall receive 50% of the adjusted units, net of taxes as described below.

The 4/26/07 PSA granted a target award of 470 units based on performance year 2009 will be reviewed by the company in early 2010 and the award will be adjusted accordingly. Wife shall disclose to Husband the performance adjustment for 2009 so Husband is aware of the adjusted 4/26/07 award. Wife elected to defer receipt of these shares for three years which shares will be held in trust, presumably until 2013. (The deferral date needs to be provided by Wife or Wyeth). At such time that the 4/26/07 PSA units are available for distribution, Husband shall receive 45% of the adjusted units, net of taxes as described below.

All distributions to Husband shall be made by Wyeth and if that is not possible, made by Wife within two weeks of receipt of her units. Wife shall provide Husband with all paperwork received so he can confirm the correct amount due to Husband. Husband's share is based on the award to Wife net of taxes. Initially Husband will receive his percentage of the award net of tax withholding by Wyeth. Wife will provide Husband with her federal tax returns (within two weeks of filing) for the years of the awards. If Wife's actual tax rate is less than the withholding, Wife will pay Husband the difference.

Wife will sign all authorizations required by Wyeth or the Administrator of the PSA awards to authorize Husband or his designated financial advisor to receive information regarding the PSA awards. In particular Husband shall be notified of any amendments to the PSA Plan. Husband may seek information from Wyeth or the Plan Administrator regarding the PSA Awards as needed.

Until Husband receives his share of the PSA Awards, Wife will name Husband as beneficiary of $100,000 of insurance on Wife's life until Husband receives his share of the marital PSA Awards.

Wife agrees that she will take no action to defer again the right to receive the above described marital PSA Awards unless Wife notifies Husband in writing thirty (30) days before the election and unless Husband agrees in writing to the deferral before Wife makes the election.

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