APRIL 2009, VOL. 55, NO. 6

ILLINOIS STATE BAR ASSOCIATION

TRUSTS & ESTATES

The newsletter of the ISBA's Section on Trusts & Estates

Strategic planning in divorce

Tom T. Field[1]

Recently the media has questioned whether the decline in the divorce rate is a function of the economic downturn. The media claims that fewer couples are getting divorced right now and that the divorce rate is plummeting from 50 percent of marriages ending in divorce to 33 percent of marriages ending in divorce. The current economic crisis has practitioners and clients raising questions about timing strategies, negotiation strategies and asset allocation strategies that were not typical prior to this economic climate. While many clients change their estate plans during a divorce, it doesn't seem like estate planners have participated or collaborated with matrimonial lawyers in discussing tax savings, the division of assets and allocation of assets for the benefit of children. Estate planners can bring a great deal of information to the table, especially about closely held businesses, trust structure, tax strategies and continuation strategies. Therefore, a strategic plan for preserving and dividing assets that is designed by the matrimonial attorney with an estate planner's input can significantly improve the marital settlement.[2] This article is designed to get estate planners on par with some of the thought processes and strategies used by matrimonial attorneys during this economic crisis.

A great number of creative strategies have been developed for divorce in this financial turmoil. Some people are choosing to remain married because their assets have become difficult to split and are worth far less in today's market. The primary asset causing this hesitation is the real estate. Some people are planning to hold off on their divorce until the real estate market rebounds. For those choosing to remain together the question becomes, how long are they willing to wait? What if this rebound takes as long as seven or ten years, as some experts have predicted What makes more sense for a client that had good earnings or considerable assets that have gone down in value is to get divorced NOW. Though this may not be a good public service announcement, it debunks the myth that one needs to wait for the real estate and stock markets to revive to get divorced. To illustrate:

> Client earned $500,000 per year and was laid off from his job. The marital estate was $3.5 million eighteen months ago and is now valued at $2.1 million, of which $1 million represents the newly appraised value of the house. The client is a professional who has a strong skill set and is likely to obtain new employment within the next two years. The spouse is a stay at home parent and will be entitled to maintenance and child support once the dissolution is completed. If the client divorces now, the client is likely going to pay a reduced amount of child support and maintenance until such time as he/she is employed again. One or both of these obligations could potentially abate for some period of time as well. Further, if the client is able to retain he real estate, then the amount of equity having to be paid to the other spouse may be significantly reduced.

These aren't the only people who can benefit from the current financial crisis. There are those who are already divorced but who still have significant obligations for maintenance and child support. To illustrate:

> Client was divorced 5 years ago. He has a maintenance obligation of $17,500 per month and a child support obligation of $3,500 per month. He worked for one of the investment banks that no longer exists and had to take a job with a smaller retail bank earning only $125,000 per year (his salary was $750,000 at the time judgment was entered). This client has a slam dunk case for having his obligations reduced to much more manageable levels based on his current income.

Some of the recent issues that are clearly driven by the current financial crisis include:

1. Splitting of Retirement Accounts: A Qualified Domestic Relations Order, pronounced quadro, ("QDRO") is a court order requiring the parties to split retire-

If you're getting this newsletter by postal mail and would prefer electronic delivery, just send an e-mail to Ann Boucher at aboucher@isba.org

IN THIS ISSUE

- Strategic planning in divorce 1
- Appraisal opportunities and challenges in down markets 3
- The fine art of fine art investments 5
- Estate planning in a low interest rate environment 6
- T & E Ethics Corner 9
- Upcoming CLE programs 11

ment plans. But, what happened during 2008 was people who split retirement accounts on a dollar basis rather than on a percentage basis suffered some unexpected consequences:

> To Illustrate: A couple gets divorced August 30, 2008, and the Husband agrees to pay to the wife $75,000 from his 401(k) account in order to balance out the retirement dollars each were to receive in the divorce. The QDRO is entered on September 30, 2008, and forwarded to the plan administrator. Since the entry of the Judgment at the end of August, the balance in the Husband's account decreased from $100,000 to $50,000. How does the plan administrator split the account? Even if Wife is given the entire balance, she is $25,000 short. Most judges resolve this issue by awarding the Wife whatever percentage of the Husband's account the original award represented. So in this example, the Wife would have received 75 percent of the Husband's account or $37,500. But it is up to the Judge to determine where the risk falls. Therefore, the QDRO language should be drafted carefully to hedge the risk in uncertain economic times. Using a percentage rather than a fixed dollar amount is the best hedge.

2. Splitting Investment and Stock Accounts: Over the course of the last six or seven years, the moneyed party to the dissolution was almost always willing to hold on to illiquid assets, or those assets that had significant tax consequences, because (1) the economy was great and (2) they were encouraged to do so because more often than not, they could make it back within only a few years. This is no longer the case for the following reasons:

a. The moneyed spouse may lose or already has lost his job (e.g. investment bankers, real estate attorneys) and there is an inability to buyout the other party comfortably because these assets, or a portion thereof, will need to be liquidated.
b. The tax consequences associated with the sale of these assets, if a party is required to sell them, are too great not to share the burden.

The moral here is that investment accounts and stock accounts/options/warrants should be, whenever possible, split in-kind, in order to spread the risk between both parties to the dissolution.

3. Term for Payment of Maintenance vs. Buyout: One option is to suggest that the moneyed spouse buy out the maintenance obligation. In other words, the moneyed spouse gives the less-moneyed spouse more assets instead of paying maintenance. This is a risk-avoidance tool and avoids having the court review the amount of maintenance being paid at a later date, akin to an insurance policy. If the recipient spouse were to legitimately fail to become self-sufficient or be in a debilitating accident, or acquire a life-altering illness, a payor spouse could be on the hook for a lifetime without a maintenance buy-out.

In the current environment, maintenance buy-outs have become less common because most clients simply don't have the liquidity or extra assets to make the trade. A derivative option is to buy a termination date for the maintenance, or agree that the maintenance will end in a certain number of years. If there are not enough assets for a maintenance buy-out or a termination date buy-out, the best advice is to keep the maintenance review on as short a leash as possible and encourage the client to see you immediately if he experiences a substantial downward deviation in his financial circumstances.

4. Business Assets and Real Estate: Businesses and real estate may become money pits in a divorce. Valuations which used to be good for at least one year are now barely worth the paper they are written on as market conditions change overnight. This creates the problem of what value to place on a property when one party is going to buyout the other party's interest. The buying party has the additional leverage of saying, "You want your money? You pay my price!"

Business assets are similarly more difficult to deal with at the present because most businesses are not as prosperous today as they were a year or even a month ago. Collection of receivables, sometimes one of or the only asset in professional services businesses, is being substantially affected. Historical data from prior years is likely worthless in this environment. Does that mean the payee spouse should wait to get paid an unknown amount based on a percentage interest in the business? If the business is struggling and illiquid, this is one option. If the business is illiquid, but has sufficient cash flow, the payouts can be secured with life insurance policies. In addition, the payor spouse may post assets he is receiving in the dissolution as collateral that cannot be touched until the payout is completed. This collateral can also be used to accelerate payout if the payor becomes delinquent e.g., they are forfeited to the payee spouse to make them whole on the obligation.

5. Legal Fees: The client should pay legal fees during the proceedings from a joint marital account. More often than not, the impact of the divorce legal fees is born equally between the parties because Illinois is an equitable distribution state. In higher value cases there are sometimes pre-distributions of assets for fees. In these high value cases, there are also circumstances where large fee payments are reserved until after the entry of the judgment due to the need to liquidate an asset (real estate, business, or retirement account).

Unfortunately, we have learned that no one appears to be totally immune from the current economic downturn. But, we have also learned that there are steps we can take to mitigate its impact in a divorce scenario. These are basic lessons designed to give a practitioner fresh tools during uncertain times.

---

1. Tom T. Field is a Partner at the law firm of Beermann Swerdlove LLP. Tom specializes in matrimonial and family law in Cook and Lake County. Tom may be reached at (312) 621-9700 or ttfield@beermannlaw.com.

2. Please note that if the estate planning attorney represented both spouses for planning purposes, he or she may need a conflict waiver to continue to represent one spouse, provided their engagement letter did waive the conflict in advance.

ILLINOIS BAR FOUNDATION

Support the Illinois Bar Foundation—the charitable arm of your Association.

To receive an application, call 1-800-252-8908.