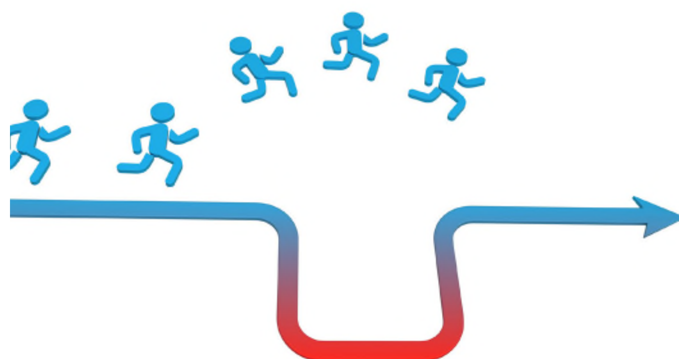
The "No Divorce Divorce" — Possibilities and Pitfalls

By Effie G. Alexander and Amy P. DeShong

The COVID-19 situation has caused some clients to take stock of their marriages, family relationships, careers, and overall goals. Some couples are finding that they no longer wish to be together. And yet, they are not necessarily interested in getting divorced.

Why would a couple choose to stay married instead of obtaining the freedom that comes with divorce?

- The financially dependent spouse has no independent access to health insurance. Or, this spouse has access, but not at comparable cost and quality of coverage. While a divorced spouse has certain rights to continued coverage under the federal COBRA statute, that coverage is expensive and only lasts for three years post-divorce. If the parties remain married, the financially dependent spouse can stay on the employed spouse's health insurance coverage.
- The spouses' religious and/or ethnic traditions discourage divorce.
- The families of origin do not support divorce. ("No one in our family gets divorced.")
- They feel that staying married is better for their minor children than getting divorced. Adult children may worry about their future inheritances, how to handle their weddings, and other major family events.
- Neither party plans to remarry; neither spouse bears animus toward the other. ("I just want to be left alone.")
- The spouses value the social attributes of continuing to be married as they continue to go about their roles at their place of worship, the country club, the children's schools, and on the charitable circuit.
- They do not wish to upend and disorder their financial lives; they wish to avoid incurring taxes; they like the additional savings of bundled car and other insurance; they wish to share the social security benefits derived from the higher earner's employment.
- They wish to avoid conflict; they fear that litigation will turn them against one another.
- They do not believe that they can afford to get divorced.
- They have already mapped out a complicated estate plan that is based on a long and happy marriage.



What are the challenges of bringing about a "no divorce divorce"?

In Pennsylvania, one is either married or single (i.e., never married, widowed, or divorced). Our commonwealth does not offer "legal separation" as a marital status. In order to arrange their legal and financial affairs in a safe and lasting manner, the parties must be protected by a comprehensive postnuptial agreement that is every bit as detailed as any prenuptial agreement or marital settlement agreement. This agreement must be thought of by both clients as an investment. It should be negotiated as soon as possible after they separate.

Simple steps that the parties can handle on their own should be taken. For example, joint credit card accounts should be terminated at the outset of separation. Assets such as vehicles and associated loans should be retitled. Monthly bill paying should be allocated. Cellphone and other plans should be changed.

For us, it requires refreshing new thinking, as we plan for a marriage that will only end after a long and happy … *separation.*

Counsel must also plan for what happens if the happy couple decides to get divorced later. How will they define, value, and distribute their marital estate at that point? Will there be any alimony? Does it make sense to try to negotiate those details now, or is it better to wait?

If the parties wait, how will they address swings in value or increases in value of certain assets? What about volatile stock accounts? What about dissipation of assets during the separation, attributable to only one of the spouses? Who takes the hit or the gain? Should the parties simply divide all the assets as though they were divorcing at the time of separation or will they divide the

continued on page 131

The “No Divorce Divorce” — Possibilities and Pitfalls

continued from page 130

marital assets as they stand at that point in time, regardless of how the marital estate has performed?

Be aware of the following facts:

- For retirement plans that are ERISA-qualified, such as private pensions and 401(k) accounts, the spouse must stay on as beneficiary unless he or she signs a consent to change the beneficiary designation. This is not the case for union, municipal, federal, and 403(b) annuity plans, nor is it the case for Individual Retirement Accounts. Tax free interspousal transfers may not be permitted without a divorce decree. Distributions from one spouse to the other will probably be taxed and there may be a penalty.
- Spouses are permitted to file joint tax returns or married filing separate returns. Joint filing status brings joint and several liability, meaning each spouse is equally liable for the full amount of the tax regardless of what the agreement says. Married filing separately often brings a higher tax rate. Joint returns require the disclosure of post-separation income and assets, but it’s the status that offers advantages, depending on each couple’s circumstances.
- Spouses remain equally responsible for jointly held mortgages, car loans, credit cards, and other loans, regardless of the allocation in the agreement. Third party creditors, including the IRS, are not bound by the provisions of the parties’ agreement because they are not parties to the agreement.
- If the parties own real estate jointly, they retain the benefits of tenancy by the entireties, which means the creditors of one spouse cannot execute against the jointly titled property.
- A “temporary separation” can go on much longer than anyone anticipated, even until death, leaving a mess for survivors and next of kin. By operation of law, the surviving spouse is entitled to the spousal share of assets, including those assets acquired after the parties separated. That result may or may not be intended.

You must interview your client thoroughly to make sure that he or she understands the pros and cons of remaining married after that marriage is over.

What steps are undertaken in order to negotiate this agreement?

All assets and liabilities are disclosed and documented as though one is anticipating an imminent divorce. The list may be attached to your agreement as evidence that a full and fair financial disclosure was made. Incomes and sources of income are disclosed.

Next, the attorneys analyze the distribution and management of each asset in accordance with the couple’s goals. Here are some examples:

The family home

Who will reside in the home and for how long? Will it be sold? When? Will there be a gain on the sale? Do the parties understand that this gain, unless they meet the exclusion rules, will be taxed because the sale is not incident to divorce? Can they maximize this exclusion by filing jointly in the year of the sale?

How will the contents of the home be distributed? Will the occupant be prohibited from hosting renters or boarders? Is the non-occupant aware that he or she may be liable for injuries that occur during the other party’s occupancy of a jointly titled residence?

What about liability for the mortgage and home equity loans and lines of credit? What happens if the occupant defaults?

Is it better to transfer the home to the occupant spouse? Can he or she refinance the mortgage in the absence of a divorce?

What about post-separation renovations and the costs to ready the residence for sale? Will the non-occupant share in the increased value after separation? What if the increase comes about because the occupant paid down the mortgage? If the parties have a mortgage escrow, which party will receive those funds?

Retirement plans and accounts

If the parties are planning to divide funds at this time, plan for the fact that the transaction may be taxable because it is not incident to a divorce. Consider the technical rules that relate to the 10% penalty, emergency/COVID loans, and, for older couples, required minimum distributions. Are there other assets of equal value that can be awarded to the non-employee spouse? If the parties do make transfers and distributions that are intended to be final, spousal waivers must be signed and lodged with the plan administrators.

The agreement should prohibit the employed party

continued on page 132

The "No Divorce Divorce" — Possibilities and Pitfalls

continued from page 131

from borrowing against the plan or undertaking other transactions without the consent of the non-employee spouse. It's a good idea to require ongoing disclosure of the beneficiary designation and account balances. What is the remedy for unauthorized withdrawals? Will the parties share the post-separation contributions made by the employed spouse and his/her employer? What exactly will they share upon retirement? What happens when the defined pension plan goes into pay status? Does that income get included in their support discussions? Is the pension an asset or is it income?

IRAs are not ERISA plans. The owner can change the beneficiary designation at any time. Require continued disclosure and include the affirmative obligation to maintain the dependent spouse as beneficiary.

Life insurance and/or trusts

Spousal beneficiary designations should be maintained with ongoing disclosure and prohibition of any loans or withdrawals, absent agreement. Who pays the premiums? Consider setting up a life insurance trust or other trust arrangement that serves that parties' family goals. While this topic is beyond the scope of this article, consider consulting with experts who understand and can recommend family trust arrangements.

Remember, however, that any assets placed in an irrevocable trust will not be available to either spouse in equitable distribution.

Restricted Stock Units, Stock Options, Deferred Compensation Plans

Review and be thoroughly conversant with all plan documents and requirements. So many clients do not actually understand their compensation plans, so we should not rely on what they tell us or what they manage to screen shot from their laptops.

Will they share post-separation grants? Who will decide what stock gets sold and when?

Remember that the transactions will be taxed at the employee's (usually higher) tax rate. These restricted stock units pay dividends while they are under restriction, which are also taxed at the employee's rate. If you represent the employee spouse, remember not to distribute these funds prior to taxes being paid, so that you are not chasing the other spouse for his/her share. Remember also that the upfront withholding may not cover the tax that is ultimately due.

Gas, oil, and mineral rights

These may be held in a limited family partnership or family trust that should not be disturbed. If not, this is a highly specialized area of the law in which we must not dabble! The issues include the sale and preservation of timber (including valuable hardwoods), woodlands, crops, water, animals, and farmland, distribution of royalties and other payments, holding the energy companies to the obligations set forth in the leases and lease addenda, and managing the ongoing communication with the energy companies and neighboring landowners. These challenges include renewals of leases, upfront payment amounts, ending leases, and negotiating the terms of new leases.

Who will be managing all of that? Will that spouse be compensated?

Vacation homes

Issues include use and occupancy, how the couple will hold title, maintenance and other expenses, increase in value, liability concerns, whether it will be sold, and payment of taxes upon sale. If the property has been rented, remember to negotiate shared responsibility for taxes associated with the recapture of depreciation deductions that were taken during the rental years. Consider whether a spouse who moved into the vacation home is permitted to exclude gain under the principal residence rule.

For investment properties, consider the vacation home issues plus the responsibility for any vacancy taxes. How will the couple handle future changes in the law in the jurisdiction in which the properties are located? Are the parties required to file tax returns in that jurisdiction?

What about that hunting and fishing cabin that is shared with other families? Who gets to use that property?

Business interests

The non-owner spouse must be removed from responsibility for bank accounts, loans, credit cards, and leases. If the parties have jointly titled assets that serve as collateral for business loans, it may not be possible to persuade the lender to release the asset. A spouse who is self-employed may be reluctant to share post-separation earnings and even post-separation financial information with the other spouse. Sometimes spouses get along well enough that they will continue to run a business together. That arrangement gives rise to other problems if their relationship sours.

continued on page 133

The “No Divorce Divorce” — Possibilities and Pitfalls

continued from page 132

A careful review of the business documents is necessary to make sure that the dependent spouse is not exposed to liability from the past, current, or future operation of the business. While this is a topic that is beyond the scope of this article, it is an area of high risk for the dependent spouse. This is particularly true if the business is run as a sole proprietorship. Both spouses may be fully exposed to lawsuits from customers, vendors, and creditors. The parties should work closely with counsel for the business. If no counsel, the parties may elicit the help of the accountant who manages the business' books and records.

If the business owner has a proclivity for tax fraud or otherwise likes to fly too close to the sun, the best outcome for his or her spouse is probably the clean break of a divorce.

What about a business operated by one spouse that goes into decline or does very well after separation? How is the business to be valued in any later equitable distribution?

If the parties have sufficient wealth to make it possible, value the business at separation and avoid the above problems by distributing other assets to the non-owner spouse and/or providing for payments over time. Payments made over time must be appropriately secured.

Support

If one spouse will be providing long term support for the other spouse, make sure that you provide for any change in federal law with respect to the taxability/deductibility of spousal support. What if the alimony deduction comes roaring back?

You won't have a support or divorce caption, but you can provide for payment to be made by direct deposit or other regular and reliable means. The recipient spouse retains the right to file for spousal support. Consider including a provision that prohibits the payor spouse from contesting entitlement.

Will support continue if the recipient spouse co-habits? What if either spouse loses employment or experiences an increase/decrease in income? What happens when the payor spouse wishes to retire?

Other considerations.

Plan for disability and medical problems. Update powers of attorney and medical directives (“living wills”). Remember, the separated spouse is next of kin because they are staying married. Update financial powers of attorney as well.

The commonwealth has a doctrine called “necessaries” that makes both spouses liable in the event a third-party institution extends medical care to an indigent spouse. The implications of that doctrine are beyond the scope of this article, but we must take it into consideration in advising our clients on the pros and cons of staying married. While we can't alter the doctrine, we can limit its impact by consulting with elder law counsel (or “estate counsel”) with respect to this doctrine.

The spouses must have complementary estate plans unless their assets have already been distributed pursuant to the agreement. Usually, the goal is to jointly pass wealth to their children and grandchildren, but often there are also plans for jointly made charitable bequests to cultural institutions and other non-profits that have meaning to the couple. If the assets have already been divided between the parties as though a divorce were intended, the parties may feel free to draft separate estate plans. In either scenario, however, each spouse must sign valid waivers of their respective spousal rights upon the death of the other spouse.

Effie G. Alexander is a shareholder at Dickie, McCamey & Chilcote, P.C. She practices from its Pittsburgh office.
ealexander@dmclaw.com
412-392-5593.

Amy P. DeShong is a partner at Wisler Pearlstine, L.L.P., located in Blue Bell, Montgomery County.
adeshong@wispearl.com
610-825-8400.