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Splitting Up Stock Options in a Divorce

By Liz Moyer - February 28, 2014

When selling the house and splitting up the art collection and bank accounts in a divorce, don't forget one asset that may not be obvious: unexercised employee stock options.

They could be worth a lot in a divorce settlement.

Last year's stock-market rally sharply increased the value of options that many technology companies and others give employees. The typical company in the S&P 1500 granted 578,000 options in 2012, according to Equilar, a Redwood City, Calif., firm that tracks compensation data. Figures for 2013 will be disclosed in regulatory filings due in March and April.

At the same time, more divorcing couples may be confronting the issue of how to divvy them up. Couples are more likely to postpone divorce in tough economic times because divorce is expensive, according to Philip Cohen, a sociology professor at the University of Maryland, who noted in a January research paper that the divorce rate fell from 2008 to 2009, amid the financial crisis.

When the economy started to recover, more struggling couples turned to divorce, Mr. Cohen says. By 2012, the divorce rate had rebounded toward 2008 levels.

Options give employees the chance to buy a company's shares for a set price at a future date that can be years down the line. Companies often grant options to discourage employees from leaving for another job or to give them an incentive to boost shareholder value.

The ultimate value of options typically depends on what shares are trading for when the options are eligible to be exercised.

For instance, an option to buy shares at $20 is worth a lot if company stock is trading at $100 when the option is eligible to be exercised. But if shares are trading at $10, the options are basically worthless, at least for the moment.

That can make options a wild card in a divorce. Say a couple decides to split up and the husband received options that have yet to be exercised. The wife could forfeit rights to his unexercised options in exchange for keeping the couple's vacation property, and both sides could end up with assets of equal value.

But that same husband could profit handsomely if the company's share price takes off, while that same wife could end up better off with the vacation home if the share price falls.

Disputes over the potential value of options aren't new. They were central to the divorce battle between former General Electric Chief Executive Jack Welch and his second wife, Jane Beasley Welch, in 2003.

Lawyers and financial planners say the first step is to figure out how many options exist in the employee spouse's name. The nonemployee spouse can direct his or her lawyer to ask the company's humanresources department how many options the employee was granted, how many are vested already and the vesting schedule.

Some states have developed common practices for dividing options. In California, for example, the longer the wait between when the couple separates and the date on which an employee can exercise the options, the smaller the share of options the nonemployee spouse generally gets.

If a state doesn't recommend how to split the options, a couple should decide on a fair distribution without trying to figure out the future dollar value, says New York divorce lawyer Alton Abramowitz—it simply is too speculative.

After the options are divided, the divorcing couple should agree to exercise them as soon as the vesting period ends so there is no risk a delay will result in a loss of value. Meanwhile, the nonemployee spouse can have their share of the options put in a trust, lawyers say.

"You don't want to be tied to the other person's bad judgment," says Mary Schmidt, an estate lawyer in Boston.

Finally, both parties in a divorce need to consider options' tax issues. For "qualified" stock options, which can only be granted to employees, capital-gains tax of 15% to 20% applies when the stock is sold (though that can change if exercising an option triggers the alternative minimum tax).

For "nonqualified" options, which can go to a wider range of people, ordinary income tax applies to the difference between the grant price of the stock option and its fair market value on the date the option is exercised.