

Divorce, Money & You

What you need to know before you sign

Unfortunately, there are many divorces in our country. Despite a society that continues to be more “family oriented”, the overwhelming majority of marriages end in divorce. According to the US Census bureau, in 1998 more than 1.1 million divorces were finalized and divorces occur at a rate of 50% of annual marriages. With those astonishing numbers and the divorce trend remaining static, there are some important financial factors to consider when parting company.

Financial decisions that are made as part of any divorce settlement – whether it be through litigation or mediation – may very well impact the lives of both parties for years to come. As has been my experience, sometimes what appears to be equal (50/50) does not necessarily mean equitable. Here are some of the recommendations I make to clients contemplating divorce:

- Often the wife opts to keep the house, sometimes due to sentimental reasons and sometimes because of not wanting to upset minor children still living at home, but keeping the house is not always the best financial option. Depending on the length of time the home was owned, capital gains taxes might be a factor if you later decide to sell. Under current law, married couples filing jointly can exempt from taxation up to \$500,000 in capital gain on the sale of a primary residence, while single filers can exempt up to \$250,000 of capital gain from taxation. Additionally, a house is commonly referred to as an inflation hedge and does not

- generally appreciate in value as quickly as other assets, i.e. retirement plans, mutual funds, stocks, etc., so an analysis has to be made of the future value of the residence compared to the future value of other assets.
- Career assets of both spouses should be considered when determining the value of marital assets. Generally, these assets include licensing, training and education (as they relate to future earnings capability), insurance, health benefits, retirement plans, and other assets generally associated with a job. Accrued, but unused vacation and sick pay should also be considered as part of the marital assets, as these not yet paid days off can have substantial value. Enhanced earnings capacity due to higher education, certifications and licenses acquired during the marriage can also be a factored in to asset valuation. If you're unsure about the value of career-related assets, hire a divorce financial planner or accountant to determine their worth.

 - When dividing IRA accounts, the ex-spouse must take her share and put it into her own IRA within 60 days to avoid taxes and penalties prior to age 59 1/2. You, as the receiving spouse, can then make investments as you see fit. If you are the receiving spouse, do not ask for a check to be made payable to you – it must be sent directly to the new custodian (where the IRA will be held) and the splitting of the account must be outlined in the divorce agreement. If you have the check sent to you and you're younger than 59 1/2, you will be automatically charged a 10% early withdrawal penalty, plus the IRS mandated 20% federal tax withholding.

- Pensions and qualified retirement plans are divisible by Qualified Domestic Relations Order or as they're commonly called, QDRO. When divided by QDRO, retirement plans are not subject to the usual taxes and penalties that apply to early withdrawal. An important factor to consider is that not all plans allow a QDRO – this is specified in the guidelines that govern the retirement plan (also known as, the plan document.) It is very important to find out whether the plan allows QDROs, what the specifics of the plan allow and that the QDRO be drafted *before* the divorce agreement is signed.

- Life insurance needs to be considered an asset if it is cash value insurance – i.e. whole life, adjustable life, variable life and universal life. Annuities are also insurance products that have a definite value. Term insurance does not have any cash value and therefore, need not be considered.

- Inherited assets that were received during the marriage, but that have been continuously held as separate property, remain as separate property and are not considered marital assets. If an inheritance was received by one or the other spouse and then retitled in joint name or deposited into a joint account, it is then presumed to be a gift to the marriage, hence, the inheritance became marital property. Documentation of the re-titling of the asset(s) may provide the opportunity to receive a credit for the value of the inherited property.

- If you need to use some of the retirement plan assets for working capital following the divorce (i.e., a down payment on a new residence), this must be written into the divorce agreement and the money needs to be withdrawn directly from the plan before transferring your share to your own individual IRA. If you fail to take the needed money out before transferring to your own IRA and then take it out of the IRA later, you will be charged the 10% IRS mandated early withdrawal penalty (if you're younger than 59 ½) and the accrued income taxes. Taking the money directly from the plan avoids the early withdrawal penalty, but the income taxes will still be due.

- If you're awarded spousal maintenance (commonly referred to as alimony) and/or child support, these payments should be secured (guaranteed) through the purchase of life and disability insurance. My suggestion is that you should own the life insurance policy and make the premium payments to be sure that it remains in force. At the very least, you should ask that non-payment of premium notices and annual policy statements be sent to you. It is a wise idea to have your spouse obtain short and long-term disability insurance to guarantee the payment of child support and maintenance. Without either type of insurance, if your ex-spouse dies or loses his job, you could end up receiving no payments (if he dies) or greatly reduced payments (if he becomes disabled).

If you are contemplating divorce or suspect your spouse is and resolution seems unlikely, copies of the following documents should be obtained: financial and investment account

statements, mortgage and home equity loan information (current balance, payment amount, interest rate, pay off date), other liability information (auto loans, credit cards, student loans, etc.), insurance policies, tax returns from the past 3 to 5 years, investment account statements, payroll stubs, employee benefit information, social security benefits estimates and retirement plan information and statements.

Make sure that you select an attorney that specializes in matrimonial law. Rather than ask, “do you handle divorce cases?” – you should ask, “what percentage of your caseload is matrimonial?” Using the right attorney is as important as employing a divorce financial planner, who will look out for your better financial interests and help you weigh all of your options.

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