THINKING ABOUT OR RECENTLY DIVORCED? BE FINANCIALLY SMART

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Financial Issues of Divorce

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report presents financial areas that are critical to understand before, during and following a divorce.

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Thinking About or Recently Divorced? Be Financially Smart

When a marriage has broken down and a decision is made by one or both parties to divorce, the impact can be devastating. Divorce is not only devastating to the individuals involved, but also to the children, family, friends, and employers of the divorcing couple. Divorce not only has a traumatic emotional impact, but a financial impact as well. A divorce can also be very expensive. A couple may have had challenges supporting one household, and now have to face the reality of the expenses for two households.

The legal aspects of divorce are numerous and many individuals going through a divorce will benefit greatly from receiving legal advice from an attorney with experience in divorce law. There is no legal requirement to hire an attorney when divorcing, however, most couples hire attorneys to protect their interests. Additionally, attorneys are also looking for new ways to help their clients obtain an equitable financial statement, and will work together with financial advisors to sort through the myriad of financial and tax issues that impact the goal of arriving at an equitable division of assets.

As with any area that features complexity, the divorce landscape has not been immune to a history of mistakes that have been made and undesired outcomes for clients. In particular, financial analysis is required to avoid errors and oversight in the following areas, just to name a few:

- Assuming that retirement assets have the same value as non-retirement assets
- Understanding the different division methods of retirement assets
- Believing that a 50/50 division of assets is an equitable division of property
- Failing to consider the cost basis of assets & property
- Not taking into account the effect of deferred taxes when dividing the assets

The above list represents a fraction of the important financial considerations that present unique challenges in the divorce process. The goal of this paper is to outline these and many other financial items that are critical to understand before, during and following a divorce.

PRE-DIVORCE CONSIDERATIONS:

Divorce laws vary from state to state. It is important to have an understanding of the divorce statutes in your state of residence or work with an attorney specializing in divorce law of your home state. One consideration to be aware of that is governed by state statues is waiting periods.[1]

WAITING PERIODS:

There are two types of waiting periods associated with divorce:

- **Residency:** In all states, at least one of the spouses must be a resident for a certain period of time before the court has jurisdiction and the divorce proceedings can even begin. The typical length of time is 90 days. In Massachusetts, the spouse filing for divorce must have lived in Massachusetts for at least one year.
- **Waiting Period:** Sometimes referred to as the "cooling off" period. This is the minimum time it takes to complete a divorce once the complaint is filed. Each state establishes this period to ensure that both parties wish to proceed with the divorce. In many states, including Massachusetts, the waiting period is 90 days. Even though this period is relatively short, the average divorce takes about one year to settle. About 90-95% of divorce cases reach a settlement. If no settlement is reached, the parties go to court and the judge makes the final decision.

FINANCIAL AFFIDAVITS

When divorce proceedings are commenced, each spouse is required to fill out a financial affidavit. This form, which becomes part of the court record, shows income from all sources, debt (or liabilities), living expenses, and assets. Each party swears (under the pains and penalties of perjury) that the information contained on his or her affidavit is true. A judge will use the information contained in this affidavit when he or she issues temporary orders regarding separate maintenance (temporary alimony), child support, and other financial matters during the period of separation. The document is useful to attorneys, as it becomes the basis for seeking (or arguing against) temporary support and assists the attorney later during the discovery and property settlement phases of divorce.

Because the financial affidavit is signed under oath, deliberately falsifying your financial information can be considered perjury. Additionally, if your divorce ends up in trial, your credibility as a witness will be seriously undermined if your spouse's attorney can prove that you lied in your affidavit. This, of course, may sway the court's sympathy toward your spouse. And finally, even if your case never makes it to trial, your spouse may be able to force a property settlement in his or her favor if you gave false information in a court document.

It's not uncommon for spouses to be less than truthful when completing their financial statements. If you suspect that your spouse has not disclosed some assets, there are a number of places where you (or your attorney) can look for these hidden assets. The following documents should be scrutinized:

- Personal income tax returns
- Partnership and corporate tax returns
- Pay stubs

[1] It is not feasible within the scope of this article to discuss the divorce laws of all the states. In some instances, the divorce laws of Massachusetts, the resident state of our firm, are used to illustrate an example of how divorce statutes are applied.

- Savings account passbooks and statements
- Canceled checks, check registers, and bank statements
- Securities and mutual fund statements
- Children's bank accounts
- Life insurance contracts

However, it's often the case (with married couples), that one spouse handles the bills and other financial affairs for the sake of convenience. The other spouse may or may not be well informed. Therefore, it may be difficult for a spouse to determine if the other party is being truthful in the affidavit. Fortunately, you and your attorney will have many other opportunities to engage in fact-finding.

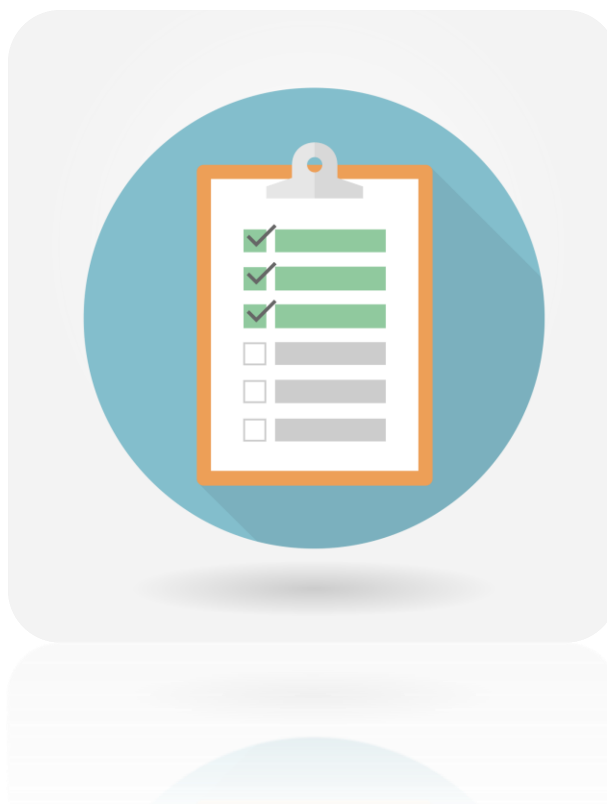
WHAT ARE SOME OF THE COMMON MISTAKES PEOPLE MAKE WHEN COMPLETING FINANCIAL AFFIDAVITS?

Sometimes hidden assets aren't the problem; frequently, people unintentionally underestimate their expenses. Some expenses are easy to estimate--car payments, mortgage payments, or utility payments, for example. Other, often smaller, expenses are easy to overlook--how much you pay for pet care, subscriptions, lawn care, or school supplies, for example. Because these types of costs can really add up, don't overlook them when completing your financial affidavit. But don't exaggerate your expenses either, because you may have to defend them.

WHAT INFORMATION MUST YOU PROVIDE IN YOUR AFFIDAVIT?

You'll probably be asked about the following:

- Name and address
- Occupation and job title
- Employer's name and address
- Frequency of your paychecks (i.e., weekly, biweekly, monthly, etc.)
- Monthly gross pay
- Type and amount of monthly payroll deductions
- Net monthly take-home pay
- Other sources (and amounts) of income
- Net monthly income from other sources
- Monthly housing expenses
- Monthly utility expenses (gas, electric, telephone, water and sewer, trash)
- Monthly grocery bill



- Monthly restaurant and entertaining expenses
- Monthly out-of-pocket medical expenses (doctor, dentist, prescriptions)
- Monthly insurance expenses (life, health, disability, homeowners)
- Monthly transportation expenses (fuel, repair and maintenance, insurance, parking)
- Monthly clothing expenses
- Monthly child-care (and child-related) expenses
- Monthly personal care and toiletries
- Educational expenses
- Miscellaneous expenses
- Debts of all kinds, including car loans, mortgages, 401(k) loans, student loans, etc. (monthly payment, unpaid balance)

Because divorce is based on state law rather than federal law, each state will have its own requirements regarding the financial statement. Nevertheless, the above-listed information is fairly typical.

DIVISION OF ASSETS

The division of assets in a divorce is dependent on the laws that govern property division in the state where the divorcing couple resides. States have adopted two different types of property division laws: community property and equitable distribution. Note that a state will fall under one of these two main categories for dividing assets, however, there are variations of rules that apply within each state.

Community Property States. In community property states, the two spouses' "separate property" is not subject to division by the court. Generally, separate property is defined as property owned before the marriage or obtained by gift or inheritance. In these states, everything else is community property and will likely be subject to a 50/50 division. [2]

Equitable Distribution States. Alternatively, in equitable distribution states the couples property and assets are "marital property" and is divided between the husband and wife equitably, or fairly. Note that an *equitable* division of assets does not necessary mean an *equal* or 50/50 division of assets.

Massachusetts, for example, is an equitable division state when it comes to dividing assets incident to a divorce. In Massachusetts, marital property includes all items, interests, and possessions obtained by a couple during the marriage. However, Massachusetts does not consider property that is acquired by either party before the marriage began, to be marital property. Property acquired before the marriage is usually considered separate property that is not divisible by the court. Note, however, that in Massachusetts and some other equitable division states, separate property may be considered marital property in certain circumstances.

[2] There are currently eight states that have adopted community property laws: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington. Alaska is an optional community property state and Wisconsin is essentially a community property state, with some exceptions to the typical community property rules.

For example, consider the situation where there has been a long-term marriage and one spouse may have entered the marriage with significantly more assets than the other spouse. The couple may have become accustomed to a certain standard of living during the marriage, therefore, the judge may consider some separate property acquired before the marriage to be marital property, with the goal of achieving a fair and equitable division of assets.

Many couples decide to attempt to divide property on their own, with the assistance of their attorney. If they can agree on how to divide their property, they create a written property settlement agreement that is submitted to the court (in Massachusetts, this is the Massachusetts Probate and Family Court). The judge takes the agreement into consideration for the final divorce order. In equitable distribution states, a judge will support a fair and reasonable division of assets.

Consider the following example of Ross and Rachel. They have been married for 30 years. Rachel had stayed home and took care of their four children. Ross earns $165,000 a year and also started a side business out of their home to generate extra revenue during retirement. He estimates the business to be worth $80,000. They own their home, which is worth $350,000, with no mortgage. Ross has a retirement plan at work, worth $250,000, and they have savings and investments owned jointly worth $50,000. Their only debt is an auto loan with a balance of $5,000.

Their total marital assets are:

House	$350,000
Retirement Plan	$250,000
Savings/Investments	$50,000
Business	$80,000
Debt	($5,000)
Total:	**$725,000**

Their assets total $730,000, minus the debt, they have total marital assets of $725,000. Assuming a 50/50 split, they would each receive $365,000 of assets and split the debt, taking on $2,500 of debt each. However, splitting the assets down the middle is not often the most equitable or feasible.

Rachel really wants to stay in the house. Ross agrees to this, but in turn wants to keep the full value of his retirement plan, the savings/investments and his business. He also agrees to assume the debt. In this case, the property division would be as follows:

	Rachel	**Ross**
House	$350,000	
Retirement Plan		$250,000
Savings/Investments		$50,000
Business		$80,000
Debt		($5,000)
Total:	**$350,000**	**$375,000**

With this proposal, Ross's assets total $375,000 and Rachel's assets total $350,000. To create a 50/50 property split, he would owe her $12,500. Ross does not want to give up any of his retirement plan and wants to keep the savings and investments. His business is not liquid, so that can't be split.

One way to even out this division is through a **property settlement note.** Ross could pay Rachel $12,500 over time, like a loan payment. They can agree that Ross will make monthly payments to Rachel, including interest. These payments are not taxable to Rachel, since they are considered a division of property in a divorce. Rachel only pays tax on the interest portion of the payments. Also, these payments are not tax deductible to Ross.

Another alternative to equalize this settlement is by dividing Ross's retirement account. Through a Qualified Domestic Relations Order (QDRO), Rachel can receive a portion of Ross's retirement plan to equal out the division of assets. Details of how a QDRO work are discussed below.

If the assets were split so that Rachel ended up with more than Ross, it would not be as feasible to execute a property settlement note for Rachel to pay Ross, since she does not work and it would be difficult for her make these payments. Also, providing Rachel with some of Ross's retirement account may equalize the division in terms of dollar value, but Rachel would have to pay taxes if she withdrew this money and since she is 55 years old, she would also pay a 10% early withdrawal penalty (assessed for accessing retirement funds prior to age 59.5).

A more reasonable settlement would be to split the savings and investments so Rachel would have some liquid assets available to her. Splitting the savings and investments 50/50 would leave Rachel with $375,000 and Ross with $350,000, but the parties and a judge may decide that this unequal division of assets is the most equitable.

CONSIDERATIONS FOR DIVIDING PROPERTY:

It may seem like a logical starting point to look at each asset and assume a 50/50 division of each account or each piece of property, however, it's not always practical to split assets this way, especially with a home or family owned business, assets that can't be easily divided in value.[3] Consideration should be given to the long-term effect on the division of assets. For example, suppose one spouse gets all assets that appreciate slowly, or depreciate and cost money to maintain (home, car, furniture, etc.), while the other spouse receives all the assets that appreciate in value or produce income (investments, retirement accounts, rental home, etc.). In this case, what may appear to be an equal division at first, will produce a wide gap in the net worth of each spouse a few years after the divorce.

In Massachusetts, the divorce laws stipulate that the following 14 factors be considered when arriving at a divorce order for an equitable division of the marital assets: length of the marriage, conduct of the parties during the marriage, age, health, station (lifestyle), occupation, amount and sources of income, vocational skills, employability, estate, liabilities and needs of each party, opportunity of each for future acquisition of capital assets and income, amount and duration of alimony, present and future needs of dependent children of the marriage.[4]

Although these factors must be considered, a judge has substantial discretion as to how much weight is afforded to each factor, if any weight at all.

Additionally, judges in Massachusetts may also consider two non-mandatory factors that can have an impact on property division on a case by case basis. These two factors are:

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[3] In divorce situations that involve a family owned business, it is important to have the business value determined by a Certified Business Appraiser, who has been specially trained in appraising businesses.

[4] Massachusetts General Law, Chapter 208, Section 34.

- **Contribution to the marital estate:** the statute specifically states that the court may consider "the contribution of each of the parties in the acquisition, preservation or appreciation in value of their respective estates".[5] For example, assets that a spouse brought into a marriage, as well as a spouse's financial contribution to the marital estate during the marriage.
- **Contribution as a homemaker**: the court also has the option to consider any spouse's non-financial contributions to a marriage, such as raising children, and other duties related to taking care of the family home.

DIVIDING RETIREMENT PLAN ACCOUNTS:

Retirement plans are assets that are generally divided between spouses in a divorce. In long-term marriages, the retirement plan(s) that clients have through their employers may be the couple's most valuable asset. Qualified retirement plans can be divided equally or unequally by using a **Qualified Domestic Relations Order (QDRO).**

A QDRO is an order from the court to the retirement plan administrator spelling out how the plan's benefits are to be assigned to each party in a divorce. A QDRO generally may not require a plan to provide any form of benefit not otherwise provided under the plan, nor may it require the plan to provide increased benefits.[6]

Defined contribution retirement plans such as 401(k)s and 403(b)s are easier to divide since they have a cash value determined daily. In some cases, companies allow an account to be divided so that the ex-spouse also has an account with the retirement plan administrator. Otherwise, when the asset is divided, the value can be transferred to an Individual Retirement Account (IRA) for the ex-spouse without triggering any tax consequences.

Note that there is a special rule related to distributions from a defined contribution retirement plan to an ex-spouse by a QDRO. Normally, a distribution from a retirement plan to a participant younger than age 59.5 is subject to a 10% penalty (in additional to the income tax owed). However, when a defined contribution plan is being divided with a QDRO due to a divorce, the recipient can elect to receive some or all of the assets up front without paying the 10% penalty. However, the distribution is subject to ordinary income tax.

For example, Bob and Cindy are getting divorced, they are both age 55. Bob's 401(k) plan has a balance of $460,000, and Cindy is going to get $230,000 from the plan. A QDRO is drafted to split the plan balance. Cindy plans to transfer most of this money to her IRA to access later in retirement, but due to attorney's fees and other expenses, she needs $40,000 right now. She requests to receive $50,000 out of her share and transfers the remaining $180,000 to her IRA. Since the administrator is required to withhold 20% of the distribution for taxes, she receives a net of $40,000, but she does not have to pay the additional 10% penalty on the withdrawal. Note that this only applies to monies requested before any transfer to an IRA is completed. If she had transferred the entire amount to her IRA, then tried to withdraw $50,000, she would have paid taxes and the 10% penalty.

[5] Ibid

[6] *The Financial Issues of Divorce*. CDFA Module Two. CertiTrek Publishing.

For defined benefit plans, such as pensions, the division is more complicated since a pension plan may define an amount of monthly benefit the recipient is to receive in retirement, but the plan may not have an account balance today. These plans can also be divided equally or unequally by using a QDRO. If the parties agree not to wait until a later date to divide the asset, it must be valued today.

To determine a current value of a defined benefit pension plan, a calculation is performed to value the future stream of income to a present value. This present value of the pension is added to the list of marital assets to be divided. It is important to pay particular attention to the assumptions used in calculating the present value of a pension plan as the calculated value is highly sensitive to the interest rates and any inflation rate that is used. [7]

A QDRO should be drafted before the parties are divorced and entered in court concurrently with the divorce decree. Also, QDROs can take considerable time to be drafted and approved by the plan, so it is advised to begin this early in the process. Note that a QDRO is not used to divide an IRA, since it is not a qualified retirement plan. In many cases, the company holding the IRA account will need to see the judgement for divorce to divide the account.

Note that when dividing retirement accounts and pensions, some states will look at the balance of the retirement account accrued prior to the marriage as not being divisible and with a pension, a formula is sometimes used to determine the amount of the pension that is subject to being divided in the divorce. For example, assume that Ross had worked at his company for 20 years and had been married to Rachel for 15 years prior to the divorce. In this case, it may be viewed that only 3/4ths of the pension's present value is considered a marital asset to be divided.

SPOUSAL SUPPORT (ALIMONY/MAINTENANCE)

Spousal support, also referred to as alimony or maintenance, is a series of payments from one spouse to the other, or to a third party on behalf of the recipient spouse. Generally speaking, for divorces that are already in effect, or become finalized before the end of 2018, spousal support payments are treated as taxable income to the recipient and tax deductible by the payor.

The Tax Cuts and Jobs Act (TCJA) of 2017 provided for sweeping changes to the tax code and had a major impact on spousal support payments. As a result of the TCJA, for post-2018 divorces, alimony is no longer taxable income to the spouse receiving the payments and is no longer tax deductible to the one who pays it. The TCJA changes alimony tax treatment only for alimony orders pursuant to an instrument of divorce entered after December 31, 2018.[8]

[7] The Pension Benefit Guaranty Corporation (PBGC), which is a federal organization, announces the monthly interest rates for the following month. These rates have become the reliable national standard for computing present values of pensions in divorce cases.

[8] Note that for divorces finalized prior to December 31, 2018, but modified after that date, commentators believe that post-TCJA tax treatment for alimony payments will apply. Further clarification from the IRS is expected on this matter.

Note that some uncertainty exists regarding the timing of a divorce and the new tax rules. Many experts believe that an instrument of divorce signed before December 31, 2018, will qualify for pre-TCJA treatment, even if the divorce is not yet final. Others interpret the rule to mean that the divorce needs to be finalized by December 31, 2018 to receive the pre-TCJA treatment for spousal support payments. At this time, further clarification is awaited from the IRS to provide more definitive guidelines on this issue. Individuals attempting to finalize a divorce near the end of 2018 are encouraged to work with their legal counsel on the issue of tax treatment for any spousal support payments.

To be considered spousal support, the payments must meet all of the following requirements:

- All payments must be made in cash, check, or money order
- There must be a written court order or separation agreement
- The order or agreement must not designate the payment as not being alimony (i.e., it cannot be designated as child support)
- The couple generally cannot live in the same household while alimony is being paid (although an exception applies in the case of payments to a separated spouse living in the same household if the payments are made under a written separation agreement, support decree, or other court order)
- The payments must terminate upon the recipient's death
- The former spouses cannot file a joint tax return

It is important to also be aware of the alimony recapture rules. Because alimony may be tax deductible, (for divorces with tax treatment under the pre-TCJA rules) some spouses are tempted to disguise property settlement payments as alimony. They might accomplish this by front-loading alimony during the first couple of years. That is, one spouse might agree to pay high sums of alimony during the first two years after the divorce, and to continue with normal payments thereafter. According to the alimony recapture rules (which are fairly complex), deductible alimony payments will be characterized as nondeductible property settlement payments to the extent that payments made during the first two years are excessively front-loaded. The recapture rules will become less of a concern for post-2019 divorces where the alimony payments are no longer deductible.

Courts will consider many factors and have discretion in establishing spousal support payments, so there are variations among states. Generally, spousal support payments are based on many factors, including:

- Need of the recipient
- Ability to pay
- Length of marriage
- Previous Lifestyle
- Age and health of both parties

For example, in Massachusetts, the Alimony Reform Act was passed in 2011 to address issues about the amount and duration of alimony payments. Under this Act, the duration of alimony depends on the length of the marriage. Duration can be no greater than 50% of length of the marriage if the duration was 5 years or less; 60% if 10 years or less, but more than 5 years; 70% if 15 years or less, but more than 10 years; and 80% if 20 years or less but more than 15 years. In a marriage which is 20 or more years, the court has the discretion to order alimony for "an indefinite length of time," but is not required to.

Alimony decisions in other states will vary depending on state laws and the level of discretion used by judges in various states when applying those laws.

SOCIAL SECURITY AND DIVORCE

Social Security has established rules defining how individuals can claim benefits off of their ex-spouse's record. After a divorce, you can claim retirement benefits based on your own earnings record (if you have accumulated enough credits to qualify for benefits), or you can claim benefits based on your ex-spouse's earnings record (whether or not you ever worked), provided that certain requirements are met.

You may qualify for benefits based on your ex-spouse's earnings record if all of the following conditions are met:

- Your ex-spouse is currently eligible to receive Social Security benefits
- You and your ex-spouse were married for at least 10 years before the divorce became final
- You are not currently married
- You are age 62 or older, and
- You aren't entitled to collect a retirement or disability benefit based on your own earnings record that equals (or exceeds) one-half of your ex-spouse's full retirement age benefit.

If you are age 62 or older and you've been divorced for at least two years, you can receive Social Security benefits based on your former spouse's earnings regardless of whether that spouse is already receiving benefits (assuming that the other requirements listed above have been satisfied).

HOW MUCH CAN YOU RECEIVE?

If you begin receiving benefits at your full retirement age (66 to 67, depending on your year of birth), your spousal benefit is equal to 50% of your ex-spouse's full retirement benefit (or disability benefit). For example, if your ex-spouse's benefit at full retirement age is $1,500, then your spousal benefit is $750. However, there are several factors that may affect how much you ultimately receive.

For example, if you're eligible for benefits based on your own earnings record then the Social Security Administration (SSA) will pay that amount first. But if you can receive a higher benefit based on your ex-spouse's record, then you'll receive a combination of benefits that equals the higher amount.

When you begin receiving benefits will also affect the amount you receive. You can receive benefits as early as age 62, but your monthly benefit will be reduced (reduction applies whether the benefit is based on your own earnings record or on your ex-spouse's.) This reduction is permanent. In other words, if you choose to receive reduced benefits at age 62, you will not be entitled to collect full benefits when you reach your full retirement age.

Note that if you were born on, or before January 1, 1954, and you're entitled to your own benefit in addition to your ex-spouse's benefit, you can file a **Restricted Application** at your full retirement age to elect only to receive the benefit based on your ex-spouse's record. This will allow your own benefit to grow at 8% per year up to your age 70, at which time you can switch to your own benefit if it's higher.

In addition, if you work after you begin receiving benefits (before you reach your full retirement age) and your earnings exceed the annual earnings limit that applies, your Social Security benefit may be reduced. Receiving a pension based on work not covered by Social Security may also result in a benefit reduction.

HOW DOES REMARRIAGE AFFECT SOCIAL SECURITY?

If your ex-spouse gets remarried and you don't, your Social Security entitlement will be unaffected.

If you remarry, you generally can't collect benefits based on your ex-spouse's record unless your current marriage ends. Any spousal benefits you receive will instead be based on your current spouse's earnings record.

WHAT IF YOUR EX-SPOUSE HAS DIED?

You may also qualify for Social Security survivors benefits based on your ex-spouse's earnings record if your former spouse has died. You may qualify if:

- Your ex-spouse was entitled to Social Security benefits
- The marriage lasted for at least 10 years before the divorce was finalized
- You are age 60 or over (or are between ages 50 and 60 and are disabled)
- You aren't currently married, and
- You aren't entitled to a retirement benefit that is equal to or greater than 100 percent of your deceased spouse's benefit

Note that if you meet the above conditions, you will be entitled to full survivors benefits; that is, you will collect an amount equal to 100 percent of your former spouse's full retirement age benefit, not merely one-half. However, if you're under full retirement age, your benefits will be reduced for each month you receive benefits under your full retirement age. Benefits at age 60 will be 71.5 percent of your former spouse's full retirement benefit.

It's also important to note that a divorced spouse may be entitled to a mother's or father's benefit if caring for the dependent child (under age 16 or disabled) of his or her deceased former spouse. Typically, the amount of a mother or father's benefit is equal to 75 percent of the deceased spouse's PIA. Unlike a spousal benefit, it isn't necessary for the marriage to have lasted 10 years.

OTHER SOCIAL SECURITY CONSIDERATIONS:

- Social Security benefits are not a marital asset subject to division, however, a judge may consider the anticipated benefits as a factor in dividing assets.
- Even if the wage-earner spouse delays receiving his or her benefits until age 70, the ex-spouse may elect to receive benefits as early as age 62 (with applicable benefit reductions, if claimed prior to their own full retirement age).
- Social Security benefits paid to a parent are includible in the parent's gross income for purposes of calculating child support.
- A valid prenuptial agreement cannot waive either party's right to apply for and receive Social Security benefits.

LIFE INSURANCE AND DIVORCE

For clients who have existing life insurance policies prior to getting divorced, it may be necessary to make changes to the policies. For example, if you have your former spouse designated as the beneficiary, you may want to change the beneficiary on the policy so your ex-spouse does not receive the death benefit. Be aware, however, that if a court has ordered you to maintain an existing policy in favor of your former spouse as part of the divorce agreement, you cannot change the beneficiary.

Alimony and child support payments will generally stop upon the death of the payor, however, future payments can be covered by using life insurance on the life of the payor if there are no other adequate ways to secure the payments. Insurance is a way to protect the recipient spouse and children who are relying on the spousal support and child support payments. Life insurance should be considered for this use as part of the final divorce settlement.

If insurance is required as part of the judgement, the insurance should be on the life of the spouse responsible for making the alimony/child support payments, and the recipient spouse should own the policy, and make the premium payments. Having the recipient spouse own the policy ensures that the premiums are being paid and the beneficiary can't be changed.

If your former spouse has an existing policy on his or her life, it can be transferred to you as the policy owner and beneficiary for the protection of your alimony/child support payments. This can be planned as part of the divorce agreement. It's also a good option when you can't obtain new insurance on your former spouse.

Note that transfers of assets, including life insurance policies, as part of a divorce agreement are considered non-taxable transfers between spouses.

If a new life insurance policy is required pursuant to the terms of the divorce agreement to cover alimony/child support payments, it is recommended to have the insured spouse apply for the insurance before the divorce is final. If he or she is unable to pass the physical exam and is not able to obtain insurance, there is still time to modify the final settlement to account for this.

DISABILITY INCOME INSURANCE AND DIVORCE:

If you receive alimony or child support, another risk to your income may arise if your former spouse becomes disabled. If he or she has no disability insurance and is unable to work, the court may modify the alimony and child support obligation, reducing or eliminating payments to you. With a disability policy, your ex-spouse will receive benefits each month and may be capable of paying the same amount of alimony and child support. Planning for disability insurance should be completed before the divorce is final. Unlike life insurance, you can't own a disability policy on someone else. So, the divorce decree may require that your ex-spouse pay the premiums on a policy and that you are entitled to regularly receive proof that the policy is in force.

DEBT AND DIVORCE

As we discussed earlier, property that is part of the marital estate is subject to be divided in a divorce. The same process is applied to debt. In general, both parties are responsible for any debts incurred during the marriage, regardless of who really spends the money. When property is divided during a divorce, the spouse who receives the asset is generally also responsible for any loans secured by that asset, such as a mortgage on a house.

For secured debt, such as a mortgage or an auto loan, it should be spelled out in the divorce agreement which party will pay each debt. Note that if one spouse fails to make a payment on a debt that is secured by an asset, the creditor can pursue payment from the other spouse.

For unsecured debt, such as credit cards and bank loans, these debts can be divided equitably in a divorce. Spouses should be aware not to run up charge accounts during a divorce as part of a perceived plan or retaliation. If it can be proven that both spouses did not agree to the expenses or they were not for necessities such as food, housing, health care, then those expenses may not be considered joint debt depending on state law and individual circumstances.

OTHER DEBT CONSIDERATIONS:

- Prior to a divorce being finalized, it is recommended that all joint credit accounts should be paid off and closed. Each spouse can open individual accounts later if they want.
- Creditors do not care how the separation agreement divides the responsibility of the debt. Each spouse is liable for the full amount of the debt on joint accounts until the bill is paid.

DO’S AND DON’TS WHEN DIVORCING:

- Do prepare a budget and a financial plan to sustain you until your divorce is final. Get help if you don’t currently have the skills and energy to do this on your own.
- Do review monthly bank and financial statements and make copies for your attorney.
- Do review all tax returns that have been filed jointly or separately by your spouse.
- Do make sure all taxes have been paid to date.
- Do review the contents of any safe-deposit boxes.
- Do get emotional support for yourself – talk to friends, join a support group, or see a therapist.
- Don’t make large purchases or create additional debt that might later cause financial hardship.
- Don’t quit your job.
- Don’t move out of the house before consulting with your attorney.
- Don’t transfer or give away assets that are owned jointly.
- Don’t sign a blank financial statement or any other document without reviewing it with your attorney.

ESTATE PLANNING AND DIVORCE

Wills for both spouses are often drawn up sometime during the marriage--particularly if there are children involved. When divorce is contemplated, the selection of beneficiaries and executors will likely be revised to reflect the absence of your former spouse. Additionally, you will need to re-examine the gift and estate tax aspects of your estate plan. For these reasons, many divorcing couples revise their estate planning documents during the period of separation or soon after the divorce has been finalized.

Divorcing couples are advised to make the necessary changes in their wills or other estate planning documents to ensure that a former spouse isn't named as your personal representative, successor trustee, beneficiary, or holder of the power of attorney. A new will, will likely be drafted during the separation period. Note that in some states, wills drawn up during a marriage are considered void after a divorce unless specifically ratified after the divorce. This means that intestacy rules would apply, instead of the will being controlling.

Finally, consider the absence of the unlimited marital deduction. A deduction is allowed for qualifying transfers to one's spouse during lifetime or at death. Because this gift and estate tax deduction is one of the most important estate planning tools for married couples, your loss of this tool at divorce can affect your tax situation adversely when you die.

SUMMARY

Divorce can be a lengthy process that may strain your finances and leave you feeling out of control. But with the right preparation, you can protect your interests, take charge of your future, and save yourself time and money. A divorce is a unique situation that requires attention to legal, financial and tax issues, all while dealing with emotional strain. In conjunction with legal counsel and in some cases, a therapist, consider also working with a financial professional to protect your financial interests and prepare properly for a secure financial future after divorce.

If you would like to discuss your personal financial situation, please do not hesitate to give our office a call at (978) 624-3000. We are here to help.

Sincerely,

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