

Breaking Up Is Hard To Do

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- ▶ Unfortunately, many marriages end in divorce. Those going through the divorce process should seek appropriate legal and financial counsel.
- ▶ A financial advisor can offer perspectives on the division of assets, as well as debts, plus the implications of alimony and child support, and the need for changes in beneficiary designations, estate planning documents, and insurance.

Approximately 2 million people in the U.S. divorce each year, with nearly 50% of first marriages ending in divorce and roughly two-thirds of second marriages. Financial issues are often a cause of breakups and can continue to be significant as partners transition to a single life. Consequently, individuals proceeding through the divorce process may want to seek the counsel of a financial advisor in addition to a divorce attorney to ensure that financial matters are addressed appropriately.

Division of Assets

A Qualified Domestic Relations Order (QDRO) is boilerplate language that should be included in a divorce agreement and approved by the family court for the division of qualified retirement plan assets to ensure a tax-free distribution. Following court approval, the QDRO then must be submitted to the administrator of the retirement plan. Without a QDRO, the distribution will be treated as a taxable payout to the account's owner and, if they are not yet 59½ years old, a 10% tax penalty will also be assessed. Individual Retirement Arrangements (IRAs) do not require QDROs, but to ensure the tax-free nature of a transfer to the ex-spouse, the divorce decree must outline its intent. To transfer the assets in an IRA, either (1) the name on the IRA must be changed to the new owner or (2) a direct trustee-to-trustee transfer must occur into the new owner's IRA. The IRA's custodian should be consulted to determine its requirements.

Other assets that are often involved in a divorce proceeding include non-retirement brokerage accounts, bank accounts, pensions, and stock options. How these assets will be allocated should also be included in the divorce agreement and the value of all marital assets should be evaluated on an after-tax basis.

The largest and least liquid marital asset is often the personal residence. If the home will be sold as part of the marriage's dissolution, then it may benefit the homeowners to sell the home while they are still technically married and filing tax returns jointly to claim as much as a \$500,000 capital gain exemption that is available for married couples. If the residence is

sold after the divorce and while single, then only up to a \$250,000 capital gain exemption would be available. If the home will be maintained by one of the parties after the marriage and a mortgage exists on the property, then a new mortgage will need to be obtained based on the continuing owner's income and assets.

Other Financial Planning Issues

Aside from the division of assets, numerous other steps should be pursued or understood during the divorce process depending on the situation: (1) The couple should pay off and close or place in the name of one person any joint accounts, such as credit card and bank accounts, as well as open individual credit card and bank accounts as needed. All parties involved should monitor their credit reports especially closely during the divorce and ensure that all joint accounts are shown as closed. (2) Alimony is tax deductible to the payer and taxable to the payee, while child support is neither tax deductible nor taxable. (3) Beneficiary designations should be updated on retirement plans, IRAs, pensions, and life insurance and annuity policies. (4) Estate planning documents, such as wills, durable powers of attorney, health care proxies, and trusts should be updated as a result of the marriage's dissolution. (5) Insurance, especially for health care, should be maintained and life and disability policies on the ex-spouse should be held if they are responsible for support payments, college tuition payments, or a future property settlement.

Divorce is usually a tumultuous and emotional process that involves significant legal and financial decisions. To ensure the divorcing parties' interests are served, each should engage appropriate professionals to provide the necessary counsel.