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Organizing Finances Before, During, and After Divorce

Aviva Pinto, CDFA®, CDS
Managing Director

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Most people don't begin their marriage expecting it to end in divorce. For those who are ending a marriage, having a sound financial plan can help keep you organized during the divorce process and help you plan for your financial future after the divorce.

GETTING ORGANIZED

You will need to gather important documents to start the divorce process. Both parties will have to complete a sworn statement of their income, expenses, assets and liabilities. This document, which is filed with the court, shows the divorcing couple's financial situation and is what the judge will use to determine alimony and child support payments.

For those who have not handled the finances, filling out this statement can be overwhelming. It helps to work with a financial advisor to navigate this process, preferably a Certified Financial Planner™ (CFP®) or Certified Divorce Financial Analyst® (CDFA®) who specializes in the financial issues surrounding divorce. Both can help you manage your immediate financial needs and help set goals and objectives for investing and retirement planning.

You will need to gather estate planning documents such as Wills, Powers of Attorney, trusts and pre-nuptial agreements. Pull together financial information such as bank account statements, investment account statements, credit card statements, tax returns for the past 5 years and business partnership agreements. Organize income information such as payroll statements, investment property income, insurance coverage information and deeds and titles for vehicles and real estate.

Having cash on hand

The divorce process can be costly. Make sure you have set aside cash to pay bills, living arrangement and cover legal fees.

Budget information

Divorce entails making the money that supported one household, support two households in the future. Knowing exactly what you spend and what you anticipate spending in the future is important to determine what you will need to sustain your lifestyle after divorce. Your budget should include all mortgage and debt payments, anticipated taxes, home maintenance, personal and household spending such as groceries, clothing, laundry, health care, insurance, attorney fees, education and entertainment spending. Your budget will show you whether you can sustain your current lifestyle or will need to increase your income or decrease spending in the future.

What you own jointly and what is your individually

If you live in a community property state[1], all marital property will be divided 50-50 according to the court unless agreed to otherwise by the divorcing spouses. If you live in an equitable distribution state, marital property will be divided between spouses in a way that is equitable, or fair. The court decides what's fair based on a set of factors that take into account the length of the marriage, each spouse's financial situation, what each of you contributed to the marriage and what each spouse will need to move forward after divorce.

So, it is important in both community property and equitable distribution divorces to have a correct assessment of what is owned jointly and what is owned separately. For example, homes, inheritances, pensions, retirement accounts, jewelry, art and collectibles.

For most couples, their home will be their largest asset. You will need to agree who will retain the marital home, or whether it needs to be sold and the proceeds used as part of the divorce settlement. Working with a Certified Financial Planner™ (CFP®) or Certified Divorce Financial Analyst® (CDFA®) will help you determine how best to split assets. Keeping the house may be your desire, but, factoring in whether you will be able to afford the mortgage, taxes and maintenance going forward in addition to your day to day living expenses, needs to be considered.

Equally important to determining which assets are yours and which assets you desire, is understanding your debts (credit card debt, vehicle loans, mortgage, student loan, etc.). Document the outstanding balances, monthly payments, and interest rates for any debts you have. In community property states any debts incurred during marriage are presumed to be owed by both spouses and must also be divided in a divorce. In an equitable distribution state, marital debt will be divided between spouses in a way that is equitable, or fair. Generally, one is only liable for their spouse's debts if the obligation is in both names.

Children

When children are involved in a divorce, custody agreements will have to be worked out between the spouses. Equally important is the child support. You will need to consider future expenses and how they will be divided. You will need to consider tuition, room, board and travel for school and college, music or dance lessons, sports activities, summer camp, semester abroad programs, travel costs if the parents (or other close relatives such as grandparents) don't live in the same area, cars or other transportation, tutors, clothing for special events, and any other expenses that go beyond the basics. It is also important that both spouses have copies of birth certificates, health and immunization records and Social Security cards.

Risk Management

Review your insurance coverage - life, disability, health care, long-term care, home, and vehicle - to make sure they are all adequate to cover your new needs. Remove your soon to be ex-spouse as a beneficiary on all policies. If you will be receiving marital support, child support, or pension payments from your spouse, make sure there is life insurance on your spouse, in case your spouse passes away before fulfilling their obligations to you. And, make sure you are named as the beneficiary of the life insurance policy. Disability insurance is also important in the event the spouse paying marital and child support becomes disabled and is unable to work to meet the agreed upon obligations. If you are not working, private health insurance after COBRA expires will be required and the costs needs to be factored into the divorce stipulation.

Tax Planning

When you are dividing assets, you will need to understand the tax consequences of liquidating anything you have. For example, if you are going to be receiving half of a taxable investment account, make sure that the assets are split equitably. Taking on highly appreciated assets that will need to be sold for liquidity will incur capital gains and you will have a large tax bill to pay. The tax implications of selling a house, selling a stock, distributing an IRA, or withdrawing from a Roth IRA can be very different from a net after-tax perspective. It is therefore important to work with a CFP® or CDFA® prior to accepting the agreement. You will also need to speak with your accountant or tax advisor to determine if you are filing your taxes single or jointly and the tax consequences of your divorce stipulations. Make sure that taxes are up to date and that you have copies of prior tax returns. Your tax professional will be able to determine whether you will be in a higher or lower tax bracket than when you were married and how this will affect your overall financial plan. If you anticipate being in a lower bracket in retirement, it may be better to fund pre-tax accounts like traditional IRAs and 401(k)s. If you expect your tax bracket to be higher in retirement, it is likely best to fund after-tax accounts like Roth IRAs or Roth 401(k)s. If you have dependents, you will also need to determine who will claim the deduction.

Inflation

Do not forget about inflation. Inflation can have dramatic long-term effects on a settlement. Agreeing to a specific settlement without considering inflation can leave you short in the future. Be sure to work inflation into your settlement negotiations.

PREPARING FOR YOUR FINANCIAL FUTURE

Once your assets are divided, make sure your home, cars, investment accounts, trusts, and other assets are retitled as needed. Close all joint checking, savings and credit card accounts and open new individual accounts. Also check your credit report and verify that joint liabilities have been removed.

Estate Planning

Meet with your trust & estate attorney to update your will, powers of attorney, trusts, and health care proxies. Make changes to terms, parties involved, and beneficiaries as needed. Also be sure to update beneficiaries on all insurance policies and investment accounts, including employer-sponsored retirement plans so you don't unintentionally leave anything to your former spouse after your divorce.

Retirement Funds

401K plans and other employer sponsored plans are more complicated to divide than savings and investment assets. If you will be receiving a portion of your spouse's retirement plan, a Qualified Domestic Relations Order (QDRO) will be issued and approved by a judge. It is important to ensure that if you decide not to defer the distribution until your spouse retires, you roll the proceeds into your own pre-tax retirement account (Rollover IRA). Money not rolled into a pre-tax retirement account will incur taxes when the money is distributed.

QDRO will detail how you and your spouse will split qualified retirement accounts such as 401(k) or pension accounts.

Social Security

One other item to consider is whether the financial impact of your divorce will change your strategy for claiming Social Security and pensions. If a couple was married for 10 years or longer prior to divorce, a non-working or lower-earning spouse is entitled to a portion of his or her spouse's social security benefits. These benefits do not impact the worker spouse's social security payments.

Comprehensive Financial Plan

After you've separated your financial lives, work carefully with your financial advisor to focus on planning your future. With your budget determined, your tax situation accounted for, you should put together a comprehensive financial plan with your financial advisor. Establish an overall plan to determine how much you will need to sustain your lifestyle and retire comfortably. Review your investment allocations to make sure they are appropriate to achieve your goals and take into account your risk tolerance and your time horizon.

A Financial Advisor can help you move forward

For some, post-divorce may be the first time they have managed their own money. A financial advisor can help execute a post-divorce financial plan and make adjustments as new circumstances and changes in assumptions require. In some cases, you may need to cut back on discretionary spending for entertainment or vacations, or move to a smaller home. Working with a financial advisor who will help you define and set financial goals, will give you the confidence you need to manage money and build a comfortable future for yourself in your new life.

Footnotes

1 Community property states are: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Alaska is an opt-in community state that gives spouses the option to make their assets community property. All other states are equitable distribution states.

*https://www.ssa.gov/benefits/retirement/estimator.html - The Social Security web site has a calculator and detailed information on determining when to claim your benefits.