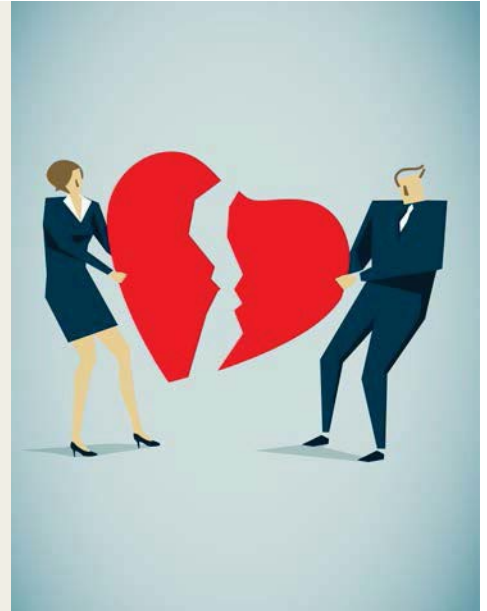


You're Getting Divorced, Now What?

Going through a divorce is a life changing experience. Along with the emotional impact of a divorce, the financial impact can be significant. The average divorce costs about \$15,000 to complete¹. Assets must be separated, housing situations will be altered, and, if children are involved, custody and visitation guidelines must be established. Some researchers estimate on average that divorcing women over 50 face a 45% drop in their standard of living, while men's standard of living dropped by 21%². It's a lot to deal with.

Though you may feel overwhelmed with all of the change, it is important to review all aspects of your new economic condition so that you can continue to meet your financial goals. Divorce is more than dividing assets and agreeing on a property settlement, it's about income and taxes, too. With this in mind, consider each of these specific financial areas of concern as you re-organize yourself.



Financial Planning Concerns

Oftentimes, one of the biggest impacts of a divorce has to do with your finances. The sooner financial issues are addressed and planned for, the more likely you will avoid potential oversights and missteps that can easily cause financial and personal stress.

When you get divorced, you may become solely responsible for supporting yourself and potentially others such as children or dependents. You will need to plan for where you are going to live and how you will cover living expenses as well as how to address other goals such as retirement or college. One of the best places to start is to construct an estimated budget. Your financial advisor can assist you in this

process. List all of your income sources such as employment wages, investment income and alimony³. Then, list your expenses including items such as household expenses, housing expenses, taxes and legal fees related to the divorce proceedings. Keep in mind that developing a comprehensive list of expenses can be tricky.

One area in particular that can create problems post-divorce is child-related expenses since these are frequently shared with your ex-spouse. It is a good idea to discuss who will be handling these types of expenses (such as tuition, braces, a car, books, a computer, etc.) and the approximate cost

¹ Crail, Chauncey; *How Much Does A Divorce Cost In 2024?* www.forbes.com/advisor/legal/divorce/how-much-does-divorce-cost/

² Lang, Tyler; *The Financial Impact of Divorce*; <https://www.forbes.com/sites/forbesfinancecouncil/2022/10/20/the-financial-impact-of-divorce/?sh=3497ccf819e5>

³ Alimony is also known as "spousal support," "maintenance," and other terms in different states. For consistency, the term "alimony" will be used universally to mean each of these terms in this document.

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prior to divorce. Also, consider having the agreement documented in the final divorce decree.

Health insurance is another expense that may be difficult to determine, especially if your spouse provided coverage through his or her employment. To address an immediate need for health insurance you may be entitled to purchase health coverage through COBRA (Consolidated Omnibus Budget Reconciliation Act), but it is only available for a maximum of 36 months. After this time, you will need to determine from where you will obtain ongoing health insurance and how much it will cost. Possible solutions could be insurance through your employer, private pay insurance or via the exchanges created by the Affordable Care Act.

When you are finished with your budget confirm that your income exceeds your expenses. It is best to be able to cover your expenses with current income rather than having to liquidate assets that may be better targeted for other purposes such as retirement accounts or a house. If your income

doesn't exceed your expenses, review the details to see if there are expenses that can be reduced or eliminated. The more income you have relative to expenses, the more you can set aside for your future goals. You will need to consider how you are going to fund your retirement. You may also have other goals such as college or travel. Your financial advisor can help analyze your progress toward these goals. They can also help you determine the right savings amount for your goals.

Of equal importance to planning for long-term goals is creating a pool of funds for an emergency. A good rule of thumb is an amount equal to at least 6-12 months of living expenses should be set aside in an account that can be easily accessed in case of an emergency. If your circumstances are evolving such as you are receiving alimony now, but won't be in the future, or you are re-entering the work force after an absence, you may need to create both a short term and a long-term budget. This will allow you to plan for your current situation as well as reflecting future changes.



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Another task should be to build a net worth statement. List all post-divorce assets as well as any liabilities. Ideally, your assets should exceed your liabilities. When reviewing your assets, consider that it is a good idea to have some diversification. It may be tempting to maintain the family home but depending on the mortgage payments and household maintenance costs, as well as what other assets are available, this may not be a good financial decision. Review your liabilities. If you have significant short-term high interest rate debt such as credit card debt, consider making a plan to reduce these items over time. Make sure these debt reduction payments are included in your budget. By considering these steps early in the process, you will be making positive steps towards ensuring your financial future.

Taxes

While this may not be the first topic on your mind, your tax situation will be changing and could have a significant impact on your finances. Some of the following issues are worth considering:

- **Filing Status:** Your filing status will be changing from married to single or head of household. This will have an impact on many items such as your tax rate schedule and standard deduction amounts.
- **Children:** If you have dependent children, another consideration is which spouse will take the child tax credit, if it is applicable, since only one taxpayer can claim a child. Usually, the tax credit goes to the parent who has primary custody for the child, but there are exceptions. However it is determined, you should consider incorporating the ultimate agreement in the final divorce decree.

- **Property Sales:** Another tax related item may pop up if property needs to be sold to generate cash. Depending on the cost basis, this may generate a taxable capital gain. For assets that aren't sold, but instead are distributed "in-kind", there would not be a tax consequence and the recipient of the property would maintain the cost basis and holding period.
- **Alimony/Child Support Payments:** Recall that since 2019, alimony is not a deductible expense to the payor, and the recipient does not have to pay income tax on alimony received. Child support is also treated the same way. As such, you may want to consider these factors as you negotiate your divorce.

Working closely with your tax advisor and divorce attorney to discuss these issues early in the process will ensure that you won't be caught off guard at tax time.

Don't Forget!

You should review your property and casualty insurance after a divorce to assure appropriate coverage.

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Retirement Planning Considerations

Assets saved for retirement are often a significant portion of net worth. Retirement accounts require special attention because the impact of divorce is unique to each type of account. Social Security and retirement accounts also represent a source of income, so it is important to work with financial, tax and legal professionals that are knowledgeable about the impacts of divorce on retirement assets and income.

Retirement Accounts

Employer-sponsored Retirement Plans

Most retirement plans will pay pension or retirement benefits directly to divorced spouses if the domestic relations order meets certain requirements. In the case of private retirement plans, a domestic relations order that meets these requirements is called a "Qualified Domestic Relations Order" or "QDRO." A QDRO is a legal document that divides an individual's retirement account with a spouse, an ex-spouse or a dependent.

Except in the case of Social Security and Tier I Railroad Retirement benefits, a court order is necessary for someone who has been divorced to get a share of retirement benefits. Plans that require QDROs would include employer-sponsored retirement plans like a profit-sharing plan, 401(k), 403(b), or a pension.

It's important to know how the retirement plan document treats a plan participant's divorce. Is the QDRO a recognized reason for a distribution from the plan? Can a distribution from the plan be made immediately or does the divorced spouse have to wait until the plan participant would be entitled to a

distribution to receive their share of the retirement assets? Not all plans will operate the same way. In either case, the plan will recognize that the former spouse is entitled to retirement benefits pursuant to the QDRO, but in some cases, they will not allow immediate distributions and instead will establish a participant account under the plan for the ex-spouse.

QDRO distributions are not subject to the 10% early withdrawal penalty when made from a qualified plan. The distribution is considered an eligible rollover distribution for the ex-spouse and therefore can be rolled into an IRA or other eligible employer-sponsored retirement plan to continue receiving the benefit of tax-deferral. However, if rolled into an IRA, the ability to take a withdrawal from the IRA before age 59 ½ without a penalty due to the divorce is no longer available. Although a QDRO distribution is exempt from the 10% penalty if taken from the employer-sponsored retirement plan, no such exception exists for IRAs.

Also, keep in mind that a traditional defined benefit pension plan does not have an "account value" that can be divided. Instead, a pension provides a retirement income stream, many times with spousal benefits after the death of the plan participant. The QDRO should specifically address the unique issues of pension plans.

Non-qualified retirement benefits are not subject to provisions of a QDRO. Make sure to work with an attorney that is experienced with the unique needs of employer-sponsored retirement benefit plans should this be an issue.

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Update Beneficiary Designations After Divorce

The distribution of IRAs, employer-sponsored retirement plans and some annuities is governed by beneficiary designations stipulated by the account owner or participant. It's important to update these designations after a divorce to be sure your intentions will be honored.

Many states have laws that automatically terminate a former spouse's interest in IRAs and other retirement plans after divorce without any action required by the asset owner. However, a U.S. Supreme Court decision makes it clear that, at least for federal retirement plans and benefit programs, relying on those state laws may be bad planning.

The court ruled that since federal law cannot be superseded by state law the only way to remove a former spouse as beneficiary under a federal benefit program is to formally change the beneficiary listed on the beneficiary designation form. Therefore, it's always a good idea to update your beneficiary designation form after a divorce, regardless of the type of retirement account or IRA you have.

IRAs

Division of IRA assets is generally outlined in the divorce decree or property settlement agreement. A QDRO is not required for employees covered by a SEP or SIMPLE IRA, or individuals who have a traditional or Roth IRA. Instead, the IRS provides for a "transfer

incident to divorce", where funds can be transferred directly from one spouse's IRA to the other spouse's IRA without tax consequences. These transfers are only tax-free if they are specifically required in the divorce decree, separate maintenance or written agreement incident to a divorce. Failure to properly divide IRAs using a trustee-to-trustee transfer can result in a taxable IRA distribution to the owner of the IRA account taking the distribution.

After a trustee-trustee transfer is completed and the IRA is divided, each IRA will be subject to its own IRA rules. With a traditional IRA, SEP, or SIMPLE IRA, if the spouse receiving the IRA needs income and is not age 59 ½, the withdrawal from the IRA would not only be taxable, but also subject to an IRS early distribution penalty, unless an exception applies. Unfortunately, if the reason for the distribution is that the money is needed to cover living expenses, there is no "financial hardship" exception for an IRA. There is, however, an emergency withdrawal exception that will permit up to \$1,000 to be distributed penalty free annually. Emergency withdrawals can be repaid within three years and must be repaid to take a subsequent emergency withdrawal.

Annuities

Annuities are not always immediately liquid, and each contract has its own rules on how it may be divided in the event of a divorce. In many cases the financial consequences of splitting an annuity include a surrender charge, loss of living income benefits and/or death benefits, and potential tax liability. As a result, it is very important to review the contract provisions when considering dividing annuity assets as a result of divorce prior to the finalization of the settlement agreement. In many cases, it might make sense to leave the annuity intact and allow one party to keep it while the other party receives another asset of equivalent value.

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Social Security

Social Security plays an important role in providing economic security for retirees. Although Social Security benefits for both spouses can be impacted by divorce, the majority of Social Security recipients are women.

Spousal Retirement Benefits

A divorced spouse is entitled to claim benefits on an ex-spouse's earnings record as early as age 62 as long as: (1) both the divorced spouse and ex-spouse are age 62 or older, (2) the ex-spouse is entitled to receive Social Security benefits, (3) the marriage lasted at least 10 years, and (4) the divorced spouse who is claiming benefits is not currently married (even if the ex-spouse has remarried). Although the ex-spouse must be entitled to receive benefits, there is no requirement that they must file for Social Security in order for the divorced spouse to receive benefits if the couple has been divorced at least two years.

Spousal benefits are based on half of the full retirement age benefit of the ex-spouse. As long as the spouse claiming spousal benefits is at least full retirement age, they will receive a 50% spousal benefit, otherwise reductions will apply if they are collected early.

When you file for benefits, you are deemed to file for all available Social Security benefits – your own and your spousal benefit – at the time of your application. If you are eligible for both your own retirement benefit and a spousal benefit, you will receive whichever amount is higher.

If you remarry, you generally cannot collect benefits on your ex-spouse's earnings record unless your later marriage also ends. If you have been divorced

more than once, you can file for spousal benefits on whichever spouse would result in the highest benefit amount, assuming you meet all the divorced spousal benefit requirements for each marriage.

Survivor Benefits

A divorced spouse can also receive survivor benefits on the record of a former spouse who died if: (1) the surviving divorced spouse is at least age 60 (or age 50 and disabled), (2) was married to the former spouse for at least 10 years, and (3) is not entitled to a larger benefit amount on his or her own work record. However, if you remarry before age 60, the prior marriage to the deceased spouse will be disregarded and survivor benefits will not be available based on that marriage. If you are age 60 or older and already receiving survivor benefits as a divorced spouse, those benefits will continue if you remarry.

Family Benefits

Social Security limits the amount of benefits that can be paid on a single individual's earning record. Each family member – spouse, dependent children, and/or ex-spouse – may be eligible for family benefits. Dependent children up to age 18 (19 if still in high school) or disabled children are entitled to benefits worth up to 50% of the parent's full retirement benefit amount. Amounts combined between minor children and spouses are subject to a maximum family benefit of 150% to 180% of the worker's full retirement benefit. However, payments to a divorced spouse do not count toward the family maximum benefit.

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Survivor benefits are equal to 100% of the deceased spouse's benefit amount, either what they were receiving or what they were entitled to receive at the time of death when they are filed for on or after the survivor's full retirement age. The benefits paid to a divorced spouse will not affect the amount paid to other family members of the deceased nor will it count toward the family maximum.

Insurance Matters

Life Insurance and Disability Insurance

Life insurance and disability insurance play a major role in effective financial planning to assure that a surviving spouse and the family maintains acceptable standards of living after the death or disability of the "breadwinner." In the case of divorce, the court may require one or both parties to maintain these types of insurance to guarantee certain financial obligations, such as alimony and child support between ex-spouses. The timeframe for this type of obligatory life insurance will vary, depending on the duration of the support settlement agreement.

Due to the importance of the insurance to the recipient and to make sure the policy stays in force; it is good practice for the ex-spouse that is receiving payments to be named both owner and beneficiary of the insurance policy and take responsibility for paying the premiums. Typically, the premium obligation can be negotiated as part of the agreement between the two parties before the divorce is finalized. It is important that the life insurance policy be established before the divorce has been finalized in case the proposed insured refuses to cooperate in getting the required medical exam or if he or she is uninsurable due to health or other reasons.

In addition to the death benefit, life insurance policies have cash value that might be overlooked in a divorce settlement. It is important to review all in-force insurance policies to analyze if they could be utilized to either provide for the financial obligations in the settlement, or as an asset to be divided. Work with your financial advisor to review existing insurance and evaluate the amount and type of coverage needed going forward.

Estate Planning

Being single versus being married has many significant estate planning effects. First and foremost, the common presumption that most of your assets should pass to your spouse is no longer appropriate. Moreover, while many states hold that a divorce creates a rebuttable presumption that the ex-spouse should not take from your estate, as discussed above federal law may override that presumption in some areas (primarily retirement assets).

Because of this, one of the first things you should do after a divorce is update your estate planning documents. This includes updating any wills and trusts, reviewing/modifying your personal representative and/or trustee designations, powers-of-attorney and health care declarations. These updates should also include reviewing and potentially updating your various beneficiary designations like your retirement plans discussed above, along with insurance policy beneficiary designations and any transfer-on-death account designations.

As you update your estate plan (or create one if you haven't already done so) you may start to run into a few complications. Most of these questions are the same questions you may have had when you were married, but the "easy default" of your spouse as a solution is no longer available:

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- Who should be responsible for your health and financial decisions if you are not able to make them?
- Who should receive your assets at your death? How should they receive those assets, outright or in a trust?
- If you have minor children:
 - Can/should your ex-spouse be the sole guardian if you pass away?
 - Who should manage the children's finances, the ex-spouse? Someone else?
- If you have stepchildren, should they be part of your ongoing legacy goals?

There are no simple answers to any of these questions. Siblings, parents, and close friends may be available to help with these responsibilities, especially the health and guardianship concerns. For financial concerns, perhaps you don't want the ex-spouse having control of the assets you leave to children/loved ones. Consequently, asking friends and family to manage your financial affairs, or the assets for your children, can be a heavy burden.

Serving as a trustee means that person is serving as a fiduciary, one of the highest levels of responsibility (and liability) under the law. Work with your financial advisor, along with your tax and legal professionals to consider whether a corporate trustee, either serving alone or as a co-trustee with your selected individual trustee, may be an appropriate solution for these needs.

As you craft your updated estate plan, review whether your legacy goals can still be met. If you were considering a gift to charity or leaving assets

to stepchildren, do you still have the desire and capability of meeting that goal? Perhaps you are concerned that your ex-spouse may not take care of the children the way you would prefer and consequently any other goals have to be readdressed.

Alternatively, if your ex-spouse has agreed to handle certain legacy goals, are you now free to explore other options with your estate? Assessing your current situation and your legacy goals will help direct you to what new actions are necessary to achieve your intentions.

For more affluent clients, being single may also mean you are more likely to have estate tax concerns at your death compared to the common married couple planning technique of delaying estate taxes until the second death.

Professional Trustees may

- Relieve loved ones from legal liability
 - Avoid or minimize the burden to an individual trustee to manage the paperwork and administrative responsibilities
 - Maintain family harmony with an objective decision maker
 - Ensure prudent, professional management
 - Provide permanence and stability
 - Deliver services with a dedicated staff of trained professionals
-

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Review your new financial situation, the federal estate tax exclusion amount, and any state estate/inheritance tax liabilities you may face. Should you be facing a potential tax, work with your professional team to create an updated estate plan that addresses this liability in the most efficient manner.

Don't Sit Idle

Divorce can be a trying time in your life. However, with proper planning and prioritization it shouldn't be an event that wreaks havoc on your financial goals. Work through each of these issues with your financial advisor, and your tax and legal advisors to assure your financial well-being will continue to be met. •

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