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Divorce Planning Considerations

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Divorce is one of life's most emotional and life-changing experiences for all parties, including children. Financial literacy is perhaps never more important. The divorce landscape is not static and a multidisciplinary approach to your divorce is wise. Consider recent legislative changes to Income tax, estate and gift taxes, state estate taxes, and family law (see below for various examples).

Division of Assets - House versus Investments

Often clients with minor children want to keep the house in a divorce, sometimes forgoing some of their rights to investment accounts. In determining the viability of keeping a house, consider your cash flow, rising property taxes, future repairs and compare historical investment rates of return to home ownership rates of return. Quitclaim deeds may be used to transfer interest in real property. If there is a mortgage and both parties are named, a refinance may have to occur. If the parties agree to sell the house, the exclusion of gain on the sale of residence may be excluded provided certain requirements are met.

Business Valuation

Business valuation is particularly important and tricky. Should the approach be assets minus liabilities, market valuation, income/cash-flow based, or some combination? What financial and labor-related contributions were given to the business by either spouse during the marriage? Estimating *future* profit from financial and labor that occurred during the marriage shouldn't be overlooked. Human capital and goodwill must also be factored. Did most of the marital money reinvest back into the business as opposed to the household? Could your spouse argue that he or she is entitled to a larger percentage of your business because he or she did not derive financial benefit during the marriage? Finally, under the Tax Cuts and Jobs Act implemented in December 2017, many pass-through entities are seeing increased cash flow and reduced taxes further complicating the divorce process for both business valuation and child support.

Tax Considerations

Income taxes are often overlooked during the division of property. **1) Basis** It's important to understand the tax basis of the property and whether that basis carries over. Most transfers between spouses/former spouses incident to divorce are non-taxable. However, there are exceptions such as nonresident alien spouses and transfers occurring greater than one year after the marriage dissolved. Ideally, judgments should require at the time of transfer that the transferor supply the transferee with records to determine the basis and holding period of the property. Consider tax basis when dividing property in a community property state since those states require the court to divide the community estate equally absent agreement of the parties or otherwise by law. **2) Other tax considerations** The right to deduct losses associated with an asset may be transferred depending on the type of asset. For asset transfers involving income, it is important to recognize that income is taxed to the person who earns it. If income has *already been earned*, a spouse cannot assign the right to receive income to the other spouse even by contract. However, future income can be transferred to the other spouse. There are exceptions under federal law (state law may differ). **3) Before Age 59.5** Withdrawals from qualified accounts before the age of 59.5 may be subject to a penalty unless 72T or another exception applies. **4) Tax Return** If you are legally divorced by year end, you must file single or head of household. If not legally divorced, you may file married filing jointly or separately (each has different financial and legal ramifications).

Alimony

Alimony is no longer deductible by the payor nor includable in income for the recipient for divorces or separation agreements executed after December 31, 2018. Executed prenuptial agreements allowing for the deduction of alimony in place prior to December 31, 2018 may or may not hold up in court. Alimony recipients may want to consider whether tax-free alimony precludes them from making IRA contributions and whether they qualify for income-based benefits. Whereas, alimony payors may want to steadfastly negotiate for lesser alimony payments due to the lack of deduction.

QDRO

Engage in conversation with your attorney about the valuation date for accounts split by a qualified domestic relations order (QDRO). Is the value based on the date of marriage dissolution or the date the divorce proceeding began or some other date? When is the account to be split? Who is charged with paying for the QDRO and getting the QDRO completed? Did the attorney address COLA, death/surviving spouse rights, shared or separate interest? Confirm that the assets named in the QDRO can be divided (some government plans cannot). Seek QDRO counsel at the onset of the divorce to avoid costly mistakes.

Estate Planning

Remember to update all beneficiary designations on qualified accounts such as 401(K) plans, IRAs, and pension plans and for nonqualified accounts with named beneficiaries such as life insurance, annuities, and transfer on death accounts. Updating your Will and Trust documents **do *not*** override your named beneficiaries on the above type of accounts.

Same-Sex Marriage

If a same-sex couple has a civil union or domestic partnership before legal marriage, those contracts may not be overridden by marriage. The date of marriage is important in terms of social security and pension benefits. Is the date of marriage when a couple became legally married? Is it when they became civil union partners?

Conclusion

Many professionals may be involved in a divorce. A family law attorney facilitates the divorce process. A CPA can assist with tax issues that arise and an estate planning attorney can help re-draft estate planning documents. Consider hiring a Certified Divorce Financial Analyst® (CDFA) for divorce specific financial forecasting and expertise. Certified Divorce Financial Analysts® illustrate the division of assets and ensuing tax consequences, cash flow, income needs/withdrawals, retirement projections and risk management. Frontier employs CDFAs as well as CERTIFIED FINANCIAL PLANNER™ professionals who work collaboratively with your other trusted professionals. The financial decisions you make or do not make today will transform your future.

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