

# Divorce

## Navigating the tax and financial aspects

If a divorce is in your future, you have a lot on your mind — the household, mixed emotions, perhaps children. But now is not the time to overlook your finances. Each case is different, and there's no pat answer. To help reduce the likelihood that a divorce will disrupt your tax and investment strategies, you need to understand a few fundamentals.

The rules governing divorce are complicated and vary by state. The following is intended to provide only an overview of the issues involved. Always consult your attorney and tax advisor about your specific situation.

### Your changing tax picture

If you're faced with a divorce, you need to be aware of a variety of general considerations about your tax situation.

**Filing status.** Most married couples file a joint return that provides a variety of tax advantages. A divorce, of course, changes that. In general, you are considered married for the entire year and can continue to file jointly if you have not obtained a final decree of divorce or separate maintenance (the document that puts the terms of a legal separation into writing) by the last day of the tax year, December 31.

**Tax benefits for dependents.** There are several types of tax credits that may apply related to your children, such as the child tax credit, dependent care credit, or education credits. You should consider which parent will claim these tax benefits and document the decision as part of the divorce agreement.

**Alimony.** The taxability of alimony payments will depend on the date of execution of the divorce decree, separation agreement, or modification due to the passage of the Tax Cuts and Jobs Act of 2017.

Alimony payments required under a divorce decree or separation agreement executed on or before December 31, 2018, follows old rules. The payer can deduct alimony payments and the recipient must report the amounts received as taxable income.

Alimony payments for any divorce decree, separation agreement, or modification (specifically stating new rules apply) executed after December 31, 2018, is no longer deductible by the payer and is not considered taxable income to the recipient. Keep in mind that not all payments made under a divorce or separation agreement are considered alimony; these rules apply only to alimony payments. Your tax advisor can help determine which payments qualify as alimony.

**Investment and Insurance Products are:**

- **Not Insured by the FDIC or Any Federal Government Agency**
- **Not a Deposit or Other Obligation of, or Guaranteed by, the Bank or Any Bank Affiliate**
- **Subject to Investment Risks, Including Possible Loss of the Principal Amount Invested**

**Child support.** Child support payments are neither deductible by the payer nor taxable to the payee.

**Pre- or post-nuptial agreements.** A pre-nuptial or post-nuptial agreement can change how certain assets and/or income will be handled in a divorce. Before signing any agreement, be sure to discuss the implications with legal and tax advisors who are knowledgeable in divorce and taxes. This step is essential to providing an equitable settlement.

## Managing retirement accounts

If you contribute to a retirement plan, such as a 401(k) or an IRA, you're probably planning to use those funds to finance a significant portion of the expenses you'll incur in retirement. In a divorce, you need to take measures to help protect these assets.

If you or your spouse have funds in an employer-sponsored retirement plan, it's usually vital to obtain a qualified domestic relations order (QDRO, pronounced "quad row"). This is a court order, judgment, or decree related to child support, alimony, or property rights instructing a retirement plan administrator on how to pay benefits to an ex-spouse or dependent of the participant.

A QDRO can provide protection above and beyond what a divorce decree offers. Don't assume you're protected just because your divorce decree indicates you have a right to your ex-spouse's pension funds. To help ensure your rights are protected, consult with your attorney about obtaining a QDRO.

A QDRO establishes a spouse's right to receive a designated portion of an ex-spouse's retirement plan account balance or benefit payments. The spouse receiving the money accepts responsibility for paying the taxes. Any money going from your pension plan to a non-spouse dependent is considered a distribution to you — which means you would be responsible for paying the taxes.

If you plan to use a QDRO to roll over funds from an ex-spouse's retirement plan into your IRA, keep in mind that an immediate distribution may not be possible. When you receive the money depends on the employer's plan document. If an immediate distribution is possible, take care regarding how the rollover is handled. The most efficient method is to have the money go directly from the retirement plan into your IRA.

On the other hand, if you have a check written to you, the plan will be required to withhold 20% for the IRS. So instead of receiving \$100,000, for example, you'll get a check for only \$80,000. You'll then have 60 days to deposit the check into your IRA to avoid incurring a taxable distribution. If you replace the amount withheld (\$20,000 in our example) with other funds when you make your IRA deposit, you may get a refund from the IRS for that amount when you file your tax return. If you do not replace the withheld amount, it will be considered a taxable distribution to you. Distributions made from an employer retirement plan due to a QDRO would avoid the 10% IRS penalty if you are under the age of 59½. Unfortunately, if you wait until after the assets are rolled to an IRA and then take an early withdrawal (pre 59½), the 10% penalty will apply unless you are eligible for a penalty exception for IRAs.

**Take care when dealing with IRA transfers.** If your divorce decree calls for you to transfer funds from your IRA to your ex-spouse's IRA, you can do so without incurring taxes if your divorce decree includes appropriate language addressing the transfer, known as Transfers Incident to Divorce (TID). After the transfer, your ex-spouse will owe taxes when taking withdrawals and may be subject to the 10% early withdrawal penalty if under age 59½. (Qualified withdrawals from a Roth IRA are tax-free.) If your divorce decree does not include the appropriate language and you withdraw money from your IRA to pay your ex-spouse, you would owe taxes and potentially a 10% IRS penalty if you're younger than 59½. Consult your attorney to make certain you are protected.

## Stock options and restricted stock create complications

Stock options and restricted stock have become increasingly popular elements in many employees' compensation packages. Although these can be valuable benefits, they can add complexity to divorce proceedings.

**Dealing with stock options is complicated by a variety of factors, including whether:**

- The options are vested or unvested
- You live in a community-property state
- You hold incentive stock options (ISOs) or nonqualified stock options (NSOs)

**Vested vs. unvested options.** If you hold unvested stock options, you can claim they're worthless (because they cannot be exercised) and therefore should not be considered property acquired during the marriage. However, the court may rule your stock option became marital property on the grant date (when they were issued) rather than when they become vested.

If your unvested options are deemed marital property, your divorce decree should include language stipulating what will happen when the options become exercisable. For example, the court may rule you hold the unvested options for the benefit of your spouse. When the options become vested, your ex-spouse would then have the right to exercise the options through you and receive their share of the proceeds. Some companies allow unvested nonqualified options to be transferred to the nonemployee spouse and the recipient spouse would be responsible for taking steps to exercise the options.

If you hold vested options, the court could rule in several ways, for example:

- If your option program permits transfers, you could be required to transfer a portion of your options to your ex-spouse.
- If your program does not permit transfers, the court may:
  - Require you to exercise the options and deliver the proceeds to your ex-spouse (in accordance with decree or agreement)
  - Let you maintain ownership of the options after the divorce and exercise them at a time agreeable to you and your ex-spouse and divide the proceeds
  - Give your ex-spouse other assets of comparable value to the options in exchange for relinquishing any claim to the stock options.

**Community-property states vs. other states.** If you live in a community property state, you and your spouse are each entitled to 50% of the stock options acquired during your marriage. In virtually all other states, stock options are treated like the rest of your property and are subject to equitable division by the divorce court.

**ISOs vs. NSOs. ISOs provide tax advantages NSOs lack.** However, if you transfer ISOs to your spouse, the options will become disqualified — in other words, they lose the tax advantages — which won't help either party. As a result, if you hold ISOs, it may be to your benefit to negotiate an agreement that will let you hold on to these options and, perhaps, provide your ex-spouse with other property of comparable value.

The IRS will let you keep the ISOs in your name while the legal and beneficial ownership goes to your ex-spouse, if subject to the divorce decree. You would then exercise them according to his or her direction and transfer the purchased shares to him or her. It would then be your ex-spouse's responsibility to pay the exercise costs and taxes, including the alternative minimum tax (AMT), if applicable.

**Restricted stock.** A restricted stock award subject to a vesting schedule presents many of the same challenges as stock options. If the plan allows, unvested restricted stock awards can be transferred to your ex-spouse without incurring taxes. At vesting, your ex-spouse can sell the stock, and he or she would be responsible for paying any income taxes. If the plan does not permit transfers, your divorce decree can stipulate you give your ex-spouse other property of comparable value to the restricted stock, or you could agree to transfer the shares when they become vested.

## Other financial considerations

**Identify and form your own professional team.** Whether you are continuing to work with your current team of tax, legal, and financial advisors or electing to work with new professionals, be sure you apprise your team of your current situation and involve them appropriately.

**Gather key tax, investment, and financial documents.** Be sure you have your own copies and easy access to all important records. Key documents include:

- Tax returns
- Bank and brokerage account statements
- Employer stock benefit plan document/statements
- Pension/retirement account [401(k), etc.] balances/statements
- Loan documents/balances
- Prenuptial agreement
- Social Security statements

**Know all your assets' cost bases.** As you gather your financial information, it will be important to know all your assets' cost bases, as well as fair market value, so you can calculate the assets' after-tax values.

**Check your credit rating.** Request a copy of your credit report, which you can get free of charge at [annualcreditreport.com](http://annualcreditreport.com). Review it for accuracy and work to correct any errors.

## You can count on us

Divorce is hard enough without having to worry about how it will affect the financial security you've worked so hard to build. Make sure you understand the issues pertaining to your situation. Although this information is not comprehensive, a review of it combined with a discussion with your financial professional, tax advisor, and attorney can help you understand your situation and options.

Your financial professional will work closely with your attorney and tax advisor throughout the proceedings to help ensure your rights and investments are protected. Your financial professional may assist with transferring assets and retirement plans or providing asset values and cost basis information. These conversations also could uncover additional concerns or lead to opportunities to help you achieve your long-term financial and life goals.

**Estimate your post-divorce budget.** Create an individual budget (including projected income and expenses) along with a net worth statement (personal balance sheet). Factor in new expenses such as extra transportation for shuttling children between parents or extended day-care costs. Your financial professional can provide you a worksheet to assist in compiling your budget.

**Develop a plan for health care benefits.** If you are currently covered on your spouse's health care plan, you'll need to arrange for your individual coverage. Consider extending current coverage via COBRA to give you a time cushion. Don't overlook coverage for children or other dependents and be sure to incorporate those additional costs in your individual budget.

**Review insurance coverage.** Be sure you and your assets will be adequately protected after the divorce is completed. If you will receive alimony, consider purchasing a life insurance policy on your ex-spouse in case of his or her death. Consider purchasing disability and long-term care insurance for yourself.

## Review and update estate planning documents and strategies.

- Remove your ex-spouse as beneficiary, executor/personal representative, successor trustee, or agent under healthcare and property powers of attorney (as appropriate).
- If you have minor children, consider leaving any assets in a trust for the children; you will likely want to name someone other than your ex-spouse as trustee.
- Thoroughly review both primary and contingent beneficiary designations; don't overlook bank accounts, brokerage accounts, company benefits, and life insurance.



## Ready to talk?

We welcome the opportunity to work with you to help you achieve your planning goals. Contact us for more information and to learn about how we can assist you.

Contact us at [www.roseategroup.com](http://www.roseategroup.com)

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