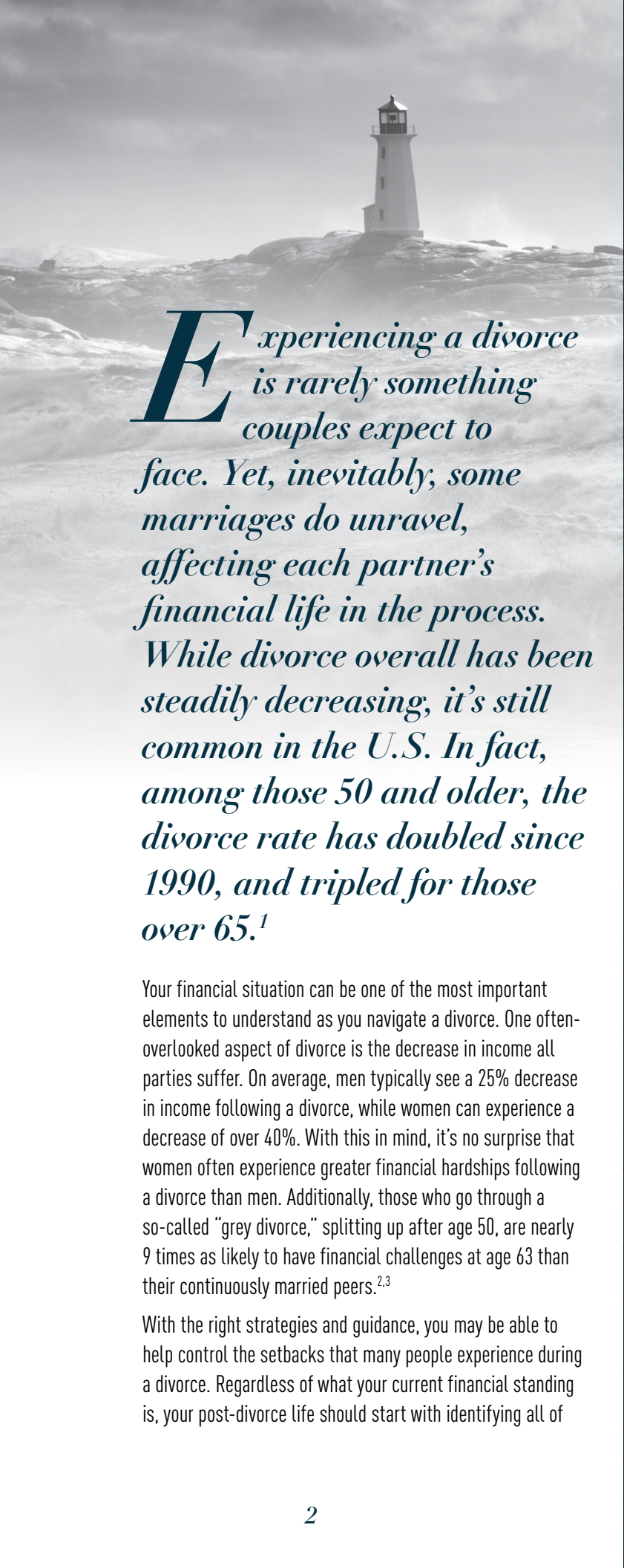




NAVIGATING DIVORCE

GETTING BACK ON SOLID FINANCIAL GROUND

Cotton Wealth Management Associates



Experiencing a divorce is rarely something couples expect to face. Yet, inevitably, some marriages do unravel, affecting each partner's financial life in the process. While divorce overall has been steadily decreasing, it's still common in the U.S. In fact, among those 50 and older, the divorce rate has doubled since 1990, and tripled for those over 65.¹

Your financial situation can be one of the most important elements to understand as you navigate a divorce. One often-overlooked aspect of divorce is the decrease in income all parties suffer. On average, men typically see a 25% decrease in income following a divorce, while women can experience a decrease of over 40%. With this in mind, it's no surprise that women often experience greater financial hardships following a divorce than men. Additionally, those who go through a so-called "grey divorce," splitting up after age 50, are nearly 9 times as likely to have financial challenges at age 63 than their continuously married peers.^{2,3}

With the right strategies and guidance, you may be able to help control the setbacks that many people experience during a divorce. Regardless of what your current financial standing is, your post-divorce life should start with identifying all of

your personal assets and searching for any potentially hidden assets. These details include everything from loans in your name to investments held in both spouses' names. By doing so, you'll be better able to claim the finances that are yours (separate property) while divvying up the ones you share (marital property). From there, you can start the process of organizing your financial life.

Navigating a divorce is rarely simple. However, with this whitepaper, you may be able to take some of the complexity out of the equation.⁴

MONEY - COVER EXPENSES AND SUPPORT YOUR NEW SINGLE LIFE

Divorce can be expensive. Not only do you need to afford your new lifestyle without your spouse, but you also need to pay for the divorce process itself. In fact, the average cost of a divorce is \$15,000 for each person, which includes court fees, attorney fees, and taxes, among other expenses. Furthermore, the costs continue even after the divorce is final. People typically need their income to increase by 30% after a divorce to support their standard of living. For people divorcing who are 50 years and older, the change can be even more drastic, with wealth often decreasing by 50%.⁵

From splitting bank accounts to identifying your net worth, how well you manage your money plays an important role in setting up your new life stage. Here are some ways to help you address money issues during a divorce.

Identify Ownership

You should have started the divorce process by listing out which assets are considered marital property and which are separate property. These details come back into play when you're addressing your money. You'll need to clearly know what you own versus what you share, and from there, you can divide them up accordingly.

Create Your Net-Worth Statement

By knowing what assets you own personally and jointly, you'll begin to create a picture of your financial worth. You'll need to capture these details in a net-worth statement that subtracts your liabilities from your assets. Keep in mind that this statement reflects where you are in your financial life today, not tomorrow. So, as you unwind your finances, focus on actions that move you forward with a stable foundation.⁶

Separate Your Finances

Next, you need to go through the process of separating your money. Remember, assets that you had before your marriage remain yours after a divorce, which includes anything you may have bought with an inheritance. Here are some key finances to address:

Bank Accounts: Separate any joint accounts you share. If you don't have one, you'll need to open up a new bank account in your name only.⁷

Credit Cards/Loans: List every credit card and loan you and your spouse have. From there, identify what designates you as a co-owner of the debt, or simply as an authorized user, and take steps to remove yourself from any joint relationship.⁷

UNTANGLING YOUR INVESTMENTS

While you and your spouse were married, you may have built part of your financial life together through investments. Those assets contribute to your net worth, what you each own separately and together, and what investments you need to split. A variety of details can affect how you split your investments. Here are some questions to consider:

- **Short-term versus long-term needs:** Do you need money now to help you both transition to this new life stage? Or, can you let some investments continue to increase in value?

SOCIAL SECURITY FOR DIVORCEES

Claiming Ex-Spousal Social Security Benefits for Income

Divorcees are often able to receive Social Security benefits from a former spouse in certain conditions. You must meet the following criteria:

- Have been married for at least 10 years
- Be currently unmarried
- Be at least 62 years old
- Have a former spouse who is able to claim Social Security or disability benefits
- Have personal Social Security benefits available to you that are less than what you'd receive from your former spouse.⁸

These benefits apply even if your former spouse remarried. Additional conditions can affect these benefits, so consult with your professional advisors on your specific financial situation.⁸



- **Delayed earnings:** Did you invest in something that started earning only after you were married? Or, did your investments accrue value before marriage?
- **Best fit:** Is receiving an investment during settlement the right financial fit for your needs? Or, would other financial options help you transition better?^{9,10}

Reinvested Settlement Money

The hope is that after your divorce is finalized, you'll have a cash settlement that's large enough to help support your immediate living costs. However, an important detail to consider is that after a divorce, individual living costs can be as much as 50% more than expenses for a couple. As a result, ensuring that you have enough income for both today and the future is important. Assuming your income meets your needs, one way you can use your settlement money strategically is by reinvesting. By doing so, you may be able to grow money for your future needs while also supporting your current quality of life.^{2,11}

Safeguard Your Lifestyle In Retirement

Retirement accounts often hold a significant portion of people's assets, especially if they've been accruing for years. When divorcing, it's critical to negotiate how you will split these accounts. Your choices largely depend on the state you live in, so make sure to work with your financial professional and legal counsel before making any moves.¹²

From defined-benefit plans to pensions, separating retirement savings in a fair manner can be complex. With thoughtful consideration, however, it's possible to soundly address them and minimize complexity.

As you move to divide retirement accounts, here are some details to keep in mind:

- **Taxes:** How will taxes affect your retirement accounts either now or in the future? Do you need to roll money over to something like an IRA?
- **Prenuptial Agreement:** Do you have a prenup in place that defines how you must handle your retirement assets?
- **Financial Stability:** If your retirement account is being split or transferred, how will this change affect you financially? On the flip side, if you're receiving these funds in a settlement, how well do they support your retirement—and do you have gaps that need to be filled?
- **Current Living Needs:** Do you have enough money to cover daily living expenses? If not, will you need to access money from a retirement account to help you?
- **Alimony for Retirement Investments:** Today's tax laws don't recognize alimony as earned income, so you can no longer use alimony payments to fund retirement accounts like IRAs and Roths. How will this change affect your financial strategies for retirement?¹³

Qualified Domestic Relations Order (QDRO)

A QDRO is a court order typically used for divorce agreements that states how much an ex-spouse needs to receive from the individual's retirement accounts. This amount is often 50% of the asset's value, accruing from the marriage's start through the divorce. A QDRO may benefit a spouse who earns less income, and individuals can list other family members as

beneficiaries to the QDRO, such as their children. These orders are only applicable for IRS tax-qualified plans covered by the Employment Retirement Income Security Act (ERISA).¹⁴

Having a QDRO isn't required for all types of retirement accounts. However, it can protect your financial interests more than your divorce agreement alone by requiring this financial relationship when splitting retirement assets. Your specific financial needs and goals will help determine whether a QDRO is suitable for your divorce agreement. Keep in mind that for the QDRO to be officially recognized, both the Plan Administrator and the court must approve the order.¹⁵

MANAGING TAX LIABILITIES

Taxes will almost certainly play a role in your finances during the divorce process. From splitting investment accounts to managing alimony, paying attention to how taxes may affect you will help maximize your settlement outcomes.

Keep in mind that this article is for informational purposes only, and not a replacement for real-life divorce tax-preparation advice. Also, tax rules are constantly changing, and there is no guarantee that the tax treatment will remain unchanged in the years ahead. A legal professional may be able to address your specific questions.

Here are key areas to include in your strategizing.

Filing Joint Tax Returns

If you filed taxes jointly, then it's important to know that the IRS considers you still married if you haven't finalized your divorce by December 31. As a result, separated couples—even if you've already filed for divorce—may be required to file joint returns in that tax year.¹⁶

If you never filed a joint return and have a dependent, you may be able to file as "Head of Household," depending on whether the IRS recognizes you as "unmarried." Your tax professional can help you identify the steps you need to take.¹⁶

Paying and Receiving Alimony

Thanks to a tax law change in 2019, alimony paid to an ex-spouse is no longer tax-deductible, and those who receive alimony will no longer pay taxes on it. Legal fees paid to

also

an attorney due to alimony arrangements may also not be tax-deductible anymore. If any of these items were listed in a pre- and/or post-nuptial agreement, they may be nullified as a result of these tax changes.¹⁷

Addressing Child Support

If you have children when you divorce, then child support is likely part of your settlement. For the person paying child support, it's important to note that these payments aren't tax-deductible, nor is the received income. Also, no one will pay taxes on child support money. These standards apply to divorces finalized after Dec. 31, 2018.¹⁸

Claiming the Child Tax Credit

If you have children who live with you for the majority of the year, then you may be able to claim the Child Tax Credit, worth a \$2,000 deduction per child. For other dependents over 16 years old, you can claim up to \$500 per child. Parents who don't have custody can only claim this credit if the other parent signs a waiver allowing them to do so.¹⁹



Paying Capital Gains Taxes

Property that transfers during a divorce isn't taxable during the settlement. However, capital gains taxes may apply later if you sell the property. Since the tax basis shifts during the divorce settlement, you may need to pay tax on the value it accrued before and after the divorce.¹⁹

Updating Your Estate Strategy

Your estate includes more than your retirement account. It also includes your home, car, art, and antiques. Essentially, everything you own factors into your estate. Protect your assets by going over your estate strategy with a fine-toothed comb with the aid of your financial professional and attorney.²⁰

PROTECT YOURSELF WITH INSURANCE

Your insurance policies also need to be reviewed during the divorce process. From removing your spouse from accounts to revising your policies, pay close attention to insurance during the divorce process. Connect with your insurance professional to make sure that all your policies have been updated.²¹

Several factors will affect the cost and availability of life insurance, including age, health, and the type and amount of insurance purchased. Life insurance policies have expenses, including mortality and other charges. If a policy is surrendered prematurely, the policyholder may also pay surrender charges and have income tax implications. You should consider determining whether you are insurable before implementing a strategy involving life insurance. Any guarantees associated with a policy are dependent on the ability of the issuing insurance company to continue making claim payments.²¹

Update Beneficiaries

If your former spouse is a beneficiary on your insurance accounts, a finalized divorce is a good time to update these details. Sometimes, a court may order you to keep your spouse listed as a beneficiary; in these cases, you must follow court orders. But, if you have no limitations—and you have children—then updating your beneficiary information to remove your spouse and add your kids can be a helpful strategy.²²

Here are some details to keep in mind:

Designating your estate as the life insurance beneficiary could cause your heirs to go through probate, which is an expensive process. Designating children who are minors is complicated, and your best option could be to set up a trust in their name as the beneficiary instead.²²

THE TAKEAWAY

Going through a divorce is rarely a simple or inexpensive process. You can help protect yourself and make the most of your opportunities by working closely with a financial representative and other divorce professionals. It may help decrease complexity, remove uncertainty, and improve fairness for all parties involved.

Remember, if you have any financial questions, we can help you navigate a complicated landscape and collaborate with your legal and tax professionals. Your happiness is our ultimate concern, and we're here for you at every step.



Footnotes, disclosures, and sources:

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