Divorce and Financial Stress

Plan ahead to avoid major financial setbacks

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Ten steps to take when preparing for a divorce

1. Avoid conflict, if you can.

Legal fees are typically the biggest cost related to a divorce. If your separation is highly contested, you can run up bills in the tens of thousands of dollars — money that gets subtracted from anything left over for you or your spouse after the divorce.

You may need the support of lawyers or a mediator, but try to keep a level head and work together on the best solution. A divorce is difficult enough without adding the additional financial strain. Do what you can to see each other's points of view and come to agreeable solutions, so you can avoid the legal back-and-forth as much as possible.

2. Add up your assets and debts and copy your financial documents.

Having your papers in order will help you form an accurate picture of your joint and individual assets and finances. Copy financial statements from your banks, your brokerages and other financial institutions you work with. Take an inventory of your physical assets — anything that has value — so that you have a full sense of your financial picture. Look at your previous tax returns if you need help figuring out income and any itemized deductions you took. All these documents will help you understand your financial situation and how it will be affected by a divorce.

Common financial documents you want to track down and copy include:

- Pay stubs or anything else showing your incomes
- Bank, mutual fund and brokerage account statements
- Loan documents
- Retirement plan statements, including any workplace or individual plans you have

- Tax returns
- Credit card statements
- Property titles
- Insurance policies or annuity contracts

You also may want to make copies of your monthly bills, to help you plan ahead for budgeting as a newly-independent person. This also is a good time to review and copy any financial documents you might have from before you were married, especially if you live in a community property state like California or Texas. Part of your divorce will be to figure out what your separate property was — property you had before the marriage took place.

3. Learn your rights to assets, child support or alimony.

Your rights to assets, child support or alimony will vary by state and individual circumstances. Check for information sites from attorneys in your home state. If you live in a community property state, learn the special rights that come with that. Here are the basics of each:

- **Assets**
  A fair agreement between you and your spouse over assets is one that benefits you both — you want to fulfill your obligations to one another with minimal conflict.
  Assets include physical objects of value, real estate, investment and retirement accounts and other things with monetary value.

  If you are considering a home as an asset, it is important to know that homes are not always the best assets to gain from a financial perspective. Houses come with a lot of expenses like mortgage balances, taxes, insurance and utilities. Real estate generally appreciates slowly. If your divorce is taking a financial toll — causing you to overspend, drain your savings or take on more debt — it may be smarter to focus on other marital assets. You can't measure the emotional significance of a home, but you can think logically and clearly about what it's financial value is.

- **Alimony**
  Alimony is a legal obligation to financially support a former spouse. In general, courts use a number of factors to determine the amount, but the most important ones are the length of the marriage and the comparative incomes of both parties. Basically, if your income is significantly below that of your former spouse and you've been married for many years, you are likely to receive alimony. However, marital assets, children, age and health and many other factors can affect alimony. The spouse who pays alimony is obligated to make payments until the end of the term of payment — which could last a lifetime. The obligation will end, however, if the receiving spouse remarries or the paying spouse dies. Alimony is taxable income to the receiving spouse and the paying spouse deducts it from his or her tax return.

- **Child support**
  Child support is a legal obligation to provide financial support to your former spouse for the care of your child or children. This is separate from alimony. Often, it's awarded to the parent with the greater portion of custody. The paying parent is obligated to pay until

the child has reached a certain age, usually 18. If the custody circumstances change — for example, if a child decides to change the parent he or she lives with — then the child support arrangement will likely change. Unlike alimony, child support is not taxable income to the receiving spouse.

If you need help with understanding your legal and financial rights when going through a divorce, self-help legal publisher Nolo Press has resources you can use:

- Nolo: www.nolo.com

4. Settle your final tax returns and debts.

It's important to settle your final tax returns and any outstanding debts you have before you finalize your divorce. It's never an easy process, so we recommend working with a tax attorney or CPA to make sure you understand your tax obligations and file your returns properly. If you have to pay taxes on any assets or you are due a refund, make sure you take care of those payments by the April 15 tax deadline.

5. Understand splitting retirement accounts.

Understand the difference between the before- and after-tax value of retirement accounts like 401(k)s or IRAs, which often are the largest asset divided in a divorce. A CPA, tax attorney or other tax professional can help with this. You want to avoid the tax penalties that come from withdrawing money from your retirement account. When possible, it's much better to divide retirement assets in a way that keeps the money in a tax-deferred retirement account.

Read up on Qualified Domestic Relations Orders (QDROs), which have to do with receiving retirement benefits, and methods of dividing IRAs. These will need to be part of your divorce settlement to be effective. Here are some resources to help:

- Department of Labor FAQs on QDROs: www.dol.gov/ebsa/faqs/faq_qdro.html
- IRS QDRO site: www.irs.gov/retirement/participant/article/0,,id=211427,00.html

6. Try to maximize your money.

Think about walking away from your divorce with as little paid out to taxes and the divorce process as possible. This can be difficult to do if it isn't you that ends up with the extra money. It's much easier if you have kids, because ultimately they should benefit if either of you ends up with a bit more money.

7. Think about all your assets and taxes related to each.

Take into account the after-tax value of the assets you're negotiating with your spouse. Tax questions often can come up with assets like your home and other real estate, retirement accounts, investments and other assets that you might restructure or sell. For each asset, be sure to start thinking about its real after-tax value if turned into cash before or after divorce. And for things like retirement accounts, think in terms of dividing the pie without either of you withdrawing from them. A tax attorney or CPA can help you look at your assets and consider options that have the best possible tax scenarios.

8. Think about all the added costs and expenses.

Understand the things that will change legally when you are no longer married and a financial professional can help you plan ahead. Health and auto insurance payments could change. If you make money on the sale of a house, a married couple can exclude $500,000 of gains without paying tax, but a single person can only exclude $250,000. It might be worth selling before the divorce. Think through all the places that you've checked off "married" on a form, and see what the result of not checking that box will be, and factor that into your divorce planning and settlement. Enlist the help of a professional to make sure you're covered.

As you're starting to budget for newly independent life, here are a few financial to-dos for you to work on:

- Review your financial situation, reset your budgeting and saving goals and create a new spending plan.
- Understand your divorce ruling to make sure you handle all your duties correctly and that you get what you should.
- Review documents like wills and powers of attorney with your lawyer.
- Look at all your financial accounts and revise your beneficiary to someone other than your former spouse.
- Review your insurance policies and understand how your policies will change in terms and cost.
- Review your tax situation and make sure all filings were completed properly during the time you were married.

9. Mediate.

Mediation is the most cost efficient and child friendly method for negotiating your divorce. An effective mediator will guide you through the process and help you and your spouse find a fair and workable settlement. Mediation is totally voluntary, and no one gives up their right to go to court if an agreement cannot be reached. However, in court you give up decision making to a judge and run the risk of a drawn out battle between the attorneys. As the adversarial process escalates, children often become pawns in this uncivil war. Anger and resentment is natural, but you should fight the instinct to hire a lawyer for the purpose of beating up your spouse. A lawyer’s proper role in your divorce is to inform you of your rights, consult with you as you negotiate, and review any agreements before you commit yourself. Of course there are occasions when one or both spouses simply cannot negotiate effectively for themselves. In these cases, we recommend that attorneys be present within the mediation room. The attorney’s presence increases costs, but still saves a bundle as the mediator keeps the focus on movement to agreement and will often insist that attorney’s sign an agreement prohibiting them from representing you in court if a mediated agreement is not found.

Finally, if your former spouse has a lawyer, you'd better have one also. We don't recommend you proceed with negotiating a divorce settlement without an attorney if your spouse has one. While you save money on legal fees by not having an attorney, you might be giving up rights you have just because there's no one to help explain and negotiate the terms of your divorce.

10. Have a secure job.

Start looking for work if you are unemployed. In most divorces, both spouses will need to have jobs after they're on their own. The sooner you can get on with a job hunt to minimize the time without income, the better. A common trigger for bankruptcies after divorce is simply the time it takes to find a job. The working spouse may need to provide some temporary support, but that's not always the case and not always possible. There's no simple answer for this, but you'll pull through faster if you start addressing the job issue once you know the divorce is coming.