



Milne Financial Planning

A Fee-Only Advisor

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Fall 1999

This issue focuses on divorce and divorce planning. For those of you who are happily married, pass it on to a friend. For the rest of you, including those who plan to marry in the future, read on.

PERSONAL

I was divorced eight years ago. At that time I had two children ages, 6 and 3. It was an unsettling time in our lives. However, I learned a lot:

- I matured from the experience and now have a better understanding of life.
- My relationship with my children improved.
- It takes awhile to really recover. It took me two or more years.
- A successful divorce (with children involved) is when every decision made is based on what is best for the children. I quickly learned they were the only important issue. Everything else was only money and revenge.
- My ex-wife and I are still the parents of our children. We feel it is important we have a non-hostile, supportive relationship. Our children really enjoy it and they benefit from an extended family.
- Don't keep the house. Sell it during the divorce.

CERTIFIED DIVORCE PLANNER

In 1997, I was certified as a divorce planner from the Institute of Divorce Planning, in Boulder, Colorado. I continued my education in divorce so that I can help others through the process.

MY BIGGEST COMPLAINT – DON'T WAIT

I don't like to complain, but people don't call early enough! People seek financial advice after the settlement is finalized, usually asking how to invest their settlement. People should seek advice as soon as the divorce process starts.

To properly set up an investment plan, a projection of a client's spending in relation to his or her income and assets is done. Unfortunately, it is often during this stage that many clients begin to understand that the settlement they just received is unlikely to provide them the standard of living they expected.

Though this realization may be disturbing, it doesn't necessarily mean that the settlement is *bad*. Often there is not sufficient money to support two households in the same lifestyle, regardless of the settlement amount. The issue is that during the divorce process a client's expectations of the settlement and the reality of the settlement should be similar. By having this information and knowledge during the settlement process, a person may negotiate a different settlement.

CLIENT PROFILE – The newly divorced

Jan came to the office after receiving a settlement in excess of one-half of a million dollars. **The problem** – Jan's settlement, though sizable, was inadequate to support her current lifestyle. More importantly, Jan didn't realize the extent of the discrepancy. The majority of Jan's settlement consisted of the marital home. Other assets included retirement monies. Jan was in her early 50's and had not worked during the marriage. Though her ability to work was not restricted, her ability to earn a decent salary was limited.

Recommendation – We were able to project the financial effects of getting a job, going back to school, selling the house, and reducing her spending. All of the alternatives would require a significant change in lifestyle.

Had Jan known the shortfall during the settlement process, she could have negotiated for, and hopefully received, a longer period of maintenance, additional funds for her education, or she could have not taken the house in the settlement.

DIVORCE PLANNING HIGHLIGHTS

- **Prenuptial agreements** where each party did not have separate legal representation are unlikely to be legally binding.
- **Mediation** can often provide the structure you need to work through the divorce process together. I believe each party should still have legal representation when using mediation.
- **Equitable settlement** does not necessarily mean that each party receives 50% of the assets.
- **Marital property** consists of all money and assets that have been co-mingled or mixed. This will likely include co-mingled gifts and inheritances.
- **Separate property** consists of money and assets that each of you brought into the marriage. Gifts and inheritances you received and that were kept separate from joint and marital assets will likely be considered separate property.
- **Earning capacity and earnings** are not to be overlooked. If you put your spouse through medical school, you may be entitled to a portion of his or her future earnings.
- **Houses** are a poor asset to receive in a settlement. They earn no income and can be costly to maintain. Often moving to a smaller home or renting makes more sense.
- **Health insurance** is a must. You can continue to receive health insurance from your ex-spouse's plan for three years after the divorce. This does not mean your ex is required to pay for it.
- **Family businesses** complicate any settlement. Again, you need an expert. Hire a qualified appraiser. It will be well worth the cost.
- **Child support** is not considered taxable income to the recipient, nor can the payer deduct it.
- **Alimony/maintenance** is considered taxable income to the recipient and is deductible (within limits) by the payer.
- **Child tax exemptions** can be traded between ex-spouses each year with form 8332.
- **Life and disability insurance** are necessary to protect child support and maintenance payments.
- **Social security** is paid to an ex-spouse if you were married for 10 or more years. You can collect ½ of an ex-spouse's social security if it

is higher than your own. This will have no effect on your ex-spouse's social security payments.

- **Capital gains tax consequences** of assets must be known. A stock you inherited from a relative 20 years ago will likely have a large capital gain. If so, selling the stock for \$25,000 may result in \$6,000 of capital gains tax.
- **Retirement and IRA tax consequences** - If you need to take money from your retirement account and you are not yet age 59 1/2, not only will you pay income taxes on any withdrawal (generally between 18%-35% of the amount taken), but you will also be charged a 10% penalty.

PENSIONS

If you or your spouse have a pension, you'll need a QDRO (Qualified Domestic Relations Order) to divide it. A QDRO is a legal document informing the retirement plan administrator how the employee's pension is to be split between the parties.

- Cash out – The non-employee receives a lump sum settlement from the plan, or receives another asset of equal value.
- Deferred division – In this case the non-employee is awarded a percentage (don't use a dollar amount) of the employee's future pension.
- Determine what happens when the employee dies. If the QDRO does not specifically break the pension into separate accounts or provide survivor ship rights, the non-employee spouse will likely receive nothing when the ex-spouse dies.
- The QDRO needs to be approved before the divorce is final. The entire QDRO will be declared invalid if it specifies a division that is not allowed in the pension plan. If you think the initial settlement is difficult, think about trying to resettle after the fact!
- Any distribution from a qualified plan, like a pension or a 401k plan, can be rolled into the non-employee's own IRA. *However*, once this money is rolled into an IRA, you can not withdraw any money without paying a 10% penalty (for those under age 59 1/2). If you'll need any of this money to support yourself, don't roll that amount needed into your own

IRA. If possible, keep it in the plan or take a distribution and pay the tax on the money you'll need now. All distributions will be considered taxable income.

- Does the plan require your ex-spouse to retire before you can collect your pension?

As elsewhere in life, information and knowledge can help you make better decisions. In divorce, there are many issues and everlasting consequences. Make informed decisions!