Key Wealth Institute

Nine Considerations When Facing a Divorce Later in Life

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Divorce can get complicated, especially when it comes later in life. Couples who have been together for years often own property and investments jointly. Now they need to divide those assets and plan for their future financial situations.

Of course, divorce involves both emotional and financial decisions. Costly mistakes can be made, so it's best to analyze decisions thoroughly and consult a tax and/or financial advisor to discuss your situation.

Here are nine considerations when approaching a divorce later in life:

1. Whether to keep or sell the marital home

Will your new life include your marital home? If so, the first step is to determine if you can qualify for a new mortgage as an individual. Talk to a lender to obtain pre-approval. Most likely you will not be able to assume the existing mortgage simply. The marital home is usually either sold immediately; transferred to one spouse while the other spouse receives other assets for fairness; or sold at a future date, such as when children finish school.

If you decide to keep your marital home, consider the maintenance, including property taxes, insurance, general upkeep, and repairs. If you buy out your ex-spouse, determine the actual costs as if you were selling to a third party. A fair appraisal is important, but if you were selling to a third party, there would be costs for repairs, bringing your home up to code, commissions, title, etc. Be sure to account for splitting these phantom costs.

If your partner wants to keep the home and sell it later, be aware of the impact on the home sale gain exclusion. If a homeowner passes the "ownership and use test" of living in a home two out of the past five years, there is a $250,000 per person exclusion of capital gains tax on the sale of a home. Couples who sell their home and independently pass this ownership and use test can shelter each spouse's share of the gain by the $250,000 exclusion when they file their taxes. With a delayed sale, however, there is a chance that a spouse may no longer meet the ownership and use test and won't qualify for the home sale gain exclusion.

2. How to equitably divide assets

Before dividing assets, understand how each investment grows and is taxed so you can compare apples to apples when it comes to taxation. A traditional IRA or 401(k) is funded with pre-tax funds, grows tax deferred, and is fully taxable at ordinary income rates (the highest) when withdrawn. So IRAs and 401(k)s will generate income tax liability on the entire balance unless they are Roth accounts, which are free from taxes if withdrawn at age 59½ or older and have been held for at least five years.

Your bank and taxable investment accounts are funded with after-tax funds, so taxes have already been paid on the principal. Be mindful of the tax basis of underlying assets.

In your divorce settlement, you will negotiate splitting your assets. A qualified domestic relations order (QDRO) can divide your retirement accounts. A QDRO is required for your plan provider to split employer retirement assets per your company plan agreement.

3. How employee benefits factor in

There are formulas to determine how to split a pension benefit equitably. One tool called the coverture fraction evaluates an equitable split considering years of marriage and length of employment.

> For example, if you've been married for 10 years and worked for the company for 20 years, the pension split may end up being based on just the 10 years of marriage.

Don't forget any executive compensation that was awarded but not vested. Unvested stock options or restricted stock that were earned during marriage can be negotiated.

4. How to account for separate or inherited property

Different states may treat inherited property differently. If you didn't comingle your property, your separate and/or inherited property held in your name may not be considered in the settlement. But this may vary.

Even if excluded from property division, the growth received on the separate or inherited asset during the marriage could be factored into the settlement agreement. Also consider that assets you could tap into, such as an unrestricted trust, could be considered for spousal support but not for property division.

5. Claiming Social Security benefits on your ex-spouse

If your ex-spouse is eligible for Social Security benefits and is over the age of 62, you may be able to claim on his or her record if you were married at least 10 years. Ex-spouses don't need to be notified; if they remarry, it won't affect your claim.

You are eligible to claim 50% of your ex-spouse's record or 100% of your own, whichever is higher. Waiting until full retirement age is often advantageous, so consult a tax or financial advisor before making any elections.

6. Determining your cash flow as an individual

Determine your income from all sources and your spending rate for fixed and variable expenses. Be sure to factor in expected but irregular expenses, such as automobile services and household repairs. Set aside funds for both emergencies and for things to look forward to, such as travel, self-care, and special purchases.

7. Newly single — a few next steps

Engage your attorney to update your powers of attorney both for health care and financial matters. You'll want to name a trusted individual to make decisions for you if you are incapacitated.

Once the divorce is final, be sure to change beneficiary designations on your retirement accounts, such as your IRAs and employer plans. You should also update life insurance policies and your will and estate-planning documents. Remember that beneficiary designations supersede all other planning documents. Simply updating your will is not enough to ensure your funds go to your intended beneficiaries.

8. Filing income taxes

Your marital status at the end of the year determines how you file your federal tax return. (You must follow the laws in your state for your state income tax return.) If your divorce decree was filed at any time during the year, you will file an individual or single return. If you have children, you may qualify for head of household status. If you are employed, review your withholding and update your W-4 to reflect your filing status change.

9. Reviewing your credit report

Credit reports are individual. A divorce may not directly affect your credit rating, but reviewing your credit report for mistakes and accounts that are not separated correctly is prudent. Check your credit report before and after your divorce as you'll rely on your individual credit in the future.

Visit AnnualCreditReport.com to obtain free credit reports from Equifax, Experian, and TransUnion.

Divorce is one of the most stressful events in life, especially when it comes later in life. Making informed financial decisions at this stage of the game is vital to your financial future. Be sure to build and maintain a network of tax and financial advisors to help you strategize on your best options as you step into your next chapter.

For more information, please contact your advisor.

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