Death & Taxes—and Divorce

[Editor's Note: This is a guest post from Alex Kilian, a wealth manager at AKT Advisors. He submitted it last February, but given the backlog in posts around here, it took me this long to get around to publishing it. We have no financial relationship. Alex asked that I remind you that neither this post, nor anything else on this site for that matter, constitutes personalized legal or financial advice.]

February; the month that encompasses President's Day and Abraham Lincoln's birthday spawned the idea that I incorporate my love of history into this article.

The ratification of the United States Constitution occurred over two hundred years ago, after which Benjamin Franklin assuredly declared the certainty of **death and taxes**. The same certainty could not yet be bestowed upon the newborn nation. While most are familiar with Franklin's famous quip, the reality of the assertion could not be more evident than to those that practice medicine.

In this world, nothing can be said to be certain, except death and taxes.- Ben Franklin

Physicians are surrounded by life, death, and everything in-between during the daily grind. One's eventual demise is not only apparent, but a given reality. And, come April 15th, many physicians are left scratching their heads as they ponder what could have been done differently to minimize last year's tax bill. In many cases, around half of income has gone to taxes. *[Presumably, Alex is counting property and sales taxes along with the usual income and payroll taxes in this total, as it would be extremely unusual for a physician to pay 50% of his gross income in just income and payroll taxes-ed.]*

Divorce is not a guaranteed certainty, but is arguably the most devastating of the three and affects roughly one-third of physicians. Many times the affected party is left in shock and awe; panic and anger ensue, the mind races with questions, and the realization that financially, your retirement plan has just derailed.

The emotional impact can be lasting. Often emotion clouds over reason and rational thinking takes a leap out the window. Divorce proceedings become costly and never-ending, custody disputes lead to favoritism among children, and nobody ends up better off.

An amicable divorce can occur, and almost every time it leads to a quicker financial recovery and a better outcome for both parties. Consider utilizing a mediator; collaboration is key. And, even if divorce has never been discussed, consider a postnuptial agreement while the two of you are still getting along. After all, marriage is a financial contract.

1) Balance Sheet

Who owns what? Build a balance sheet. Gather statements on all assets and liabilities, and determine what is owned jointly or community, and what is separate. Whether you live in a community property or equitable distribution state will help guide you through this exercise. There are currently ten community property states; Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

2) Divide by Two

Now *assume* that all assets and liabilities stipulated as joint or community will be split 50/50. But, is that fair? That depends. What is fair generally comes down to the accustomed standard of living, the earning capacity of each party, and quite frankly, the morality and honesty of each party. In reality, the higher earning spouse will generally be awarded less to much less than their “fair” share and be obligated to transfer a portion of their retirement accounts to the lower-earning spouse. This may involve a QDRO (Qualified Domestic Relations Order).

When it comes to personal property, don’t be petty. You may each have items that hold significant value to you personally, but if it can be replaced easily, avoid the conflict and let it go. An impartial team of professionals can help guide you or force you through the asset division process.

3) Spousal Support (Alimony)

If you are the sole earner in the family, you will probably be required to pay monthly spousal support to your ex-spouse. In addition, you may be required to purchase a life insurance policy on yourself with your ex-spouse listed as the beneficiary to cover the alimony payments should you predecease the full payout of the obligation.

The good news is that alimony payments are tax deductible for the payor (and taxable to the payee.) The amount you are required to pay depends on how much you earn, how the assets were divided, and the earning capacity of your soon to be ex-spouse. The duration is generally left up to the court to decide, but alimony is meant to be rehabilitative, not permanent, and can be challenged if the receiving spouse remarries.

4) Child Support

Unlike spousal support, child support is not tax deductible for the payor but is tax-free for the recipient. In addition, there are a variety of factors that are included in calculating the award; the amount of time spent with each parent, the needs of the child, and their age. In most states, child support ends at age 18 or the age of majority, with exceptions.

> *"I walk slowly, but I never walk backward." – Abraham Lincoln*

As the dust settles, and reality sets in, it is imperative for the new divorcee to move forward. Whether you find yourself divorced in the accumulation phase, pre-retirement phase, or retired phase of life will greatly dictate the possibility to build anew a firm financial foundation, or make repairs to the damage.

5) Create a budget

There is now (most likely) only one adult in the household.

What does it cost you per month to live (the essentials)? If the house was sold, or you're no longer living there, are you financially able to afford a new home? Are you planning on renting in the interim?

6) Update your estate plan

The beneficiaries on ALL accounts, insurance policies, etc. should be updated to reflect your wishes. Your estate planning documents should be reviewed in detail with your attorney to amend any changes brought about by divorce. Who do you have in mind as your new heirs? Your children? Charities?

7) Delay retirement

Many of us don't want to work any longer than we have to, but in the case of divorce, the higher earning spouse (if still working) will typically need to work longer in order to maintain a similar standard of living. Consider delaying the collection of social security benefits. If you're retired, consider going back to work or taking on a part-time job in another field to minimize the drawdown on your portfolio.

8) Increase your savings

For those that are still working, if you're the one that ended up with the smaller half, look for places in your budget that you can cut back. Or, opportunities to create additional income such as picking up additional shifts. You need to save as much as you can now while you have the ability to earn meaningful income in order to make up for the assets that were forfeited. Live cheaply now, in order to live well in retirement.

10) Relax

Focus on your passions, your hobbies, children, and extended family. Volunteer, remain active and consider joining social groups. Divorce often spawns loneliness and depression; this is especially prevalent in those that are retired or have been in long-term marriages. This is the time to start over and find a renewed sense of purpose.

What do you think? Are you divorced? What was your experience like? Have you tried to implement a pre-nuptial or even a post-nuptial agreement? What tips do you have for someone else facing a divorce? What did your divorce agreement mandate you do? What percent of your assets did you lose? How was custody determined? How was alimony determined? Comment below!