Navigating the Finances of Divorce

[Editor's Note: Today's guest post was submitted by pediatric cardiologist Joshua Daily, MD, MEd. Divorce can be personally devastating and a huge setback for your financial goals. For other WCI posts that begin to tackle the complex subject of finances and divorce click here and here. We have no financial relationship.]

Navigating the Finances of Divorce

My Story

I had been out of fellowship for two years and had settled into life as a pediatric cardiologist. I was no longer working 80 hours per week, was earning a good income, had autonomy at work, enjoyed my colleagues, and had a reasonable work-life balance. I liked my job, and I felt like I was good at it. My family life seemed to be going well. My marriage had survived 10 years of medical training and all that entails. I loved being a dad. I put my kids to bed every night, was able to coach my son's soccer team, and even taught a children's class at our church. In short, life was good. One day I came home, and my wife told me our marriage was over. She left me and immediately filed for divorce. I was in shock. I didn’t see it coming. I was flooded with feelings of hurt, sadness, anger, hopelessness, and frustration. I barely had any time to process these emotions before I was forced to try to navigate through the complexities of the legal system, take care of my two young children, and face the financial ramifications of divorce.

I consider myself more financially savvy than the typical physician, and yet I found it difficult to identify helpful resources or understand some the financial aspects of a divorce. Having gone through the process myself, I decided to write this article to highlight the most important financial aspects physicians and other high-income professionals need to consider when going through a divorce. I hope that none of you experience a divorce. However, given the divorce prevalence among physicians of 24.3%, it is likely that many of you either have or will face a divorce. For that reason, I hope this article proves helpful for those going through a divorce and additional motivation to work on your marriages for all other married readers.

Fees

Divorces are costly, especially contested divorces. Lawyers don’t bill like physicians. Every minute they spend working on your divorce is billed, including meetings, research, sending emails, phone conversations, and drafting documents. Good lawyers are expensive with hourly wages between $250 and $500 per hour. The total cost of a contested divorce depends on a number of variables. According to one study, the average contested divorce involving child custody and support issues costs $19,200. However, for many high-income professionals, a contested divorce can easily exceed $30,000 and in some cases $100,000. As a result, if you and your spouse agree to an uncontested divorce, there is the potential for some savings.

That being said, based on the additional variables discussed below, a good lawyer and a contested divorce at times can save you a lot of money in the long run if it leads to a favorable divorce agreement.

Division of Assets

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Assets are considered either marital or non-marital property. Property is considered non-marital if it was acquired prior to marriage and marital if it was acquired during marriage. For example, contributions made during the marriage to a retirement account in only one spouse’s name are marital property. While the laws depend on your state of residence, in general, marital property is split 50/50, and non-marital property is not subject to division as part of the marital estate. However, judges have leeway in determining what constitutes an equitable division of property, and in cases in which they consider an unfair hardship to exist (as may be the case in a divorce between a high-income professional and a stay-at-home parent), they may deviate from the 50/50 split. The impact of the loss of half of the savings of a late-career physician cannot be understated, as this can completely devastate any retirement plans.

One particular asset that warrants specific discussion is a home. If one spouse desires to keep the home, then he/she will usually need to pay the other spouse 50% of the home equity and refinance the home to remove the other spouse's name from the mortgage. This can be very expensive, especially for those who currently have a mortgage at a low interest rate. In addition, the spouse remaining in the home now must pay for all the home-related expenses from only his/her income, and thus selling the home and downsizing is often required.

Division of Liabilities

In general, liabilities (debt) are subject to the same marital vs. non-marital treatment. However, when a liability is tied to an asset (e.g. home mortgage), the spouse receiving the asset will also assume the liability. In addition, of particular interest to physicians, student loans are usually treated as non-marital liabilities even if they were incurred during the marriage. As a result of this treatment of student loans, in many cases, a physician will have a significantly lower net worth than his/her ex-spouse at the end of a divorce.

Alimony and Child Support

Alimony (spousal support) is financial support provided to a divorced person from the former spouse to allow the maintenance of a certain standard of living. Child support is paid by the non-custodial parent to the custodial parent to help pay for the expenses of raising children. The courts have discretion in determining the need for alimony, the amount awarded, and the duration. In the case of a high-income spouse married to a stay-at-home spouse, the judge may determine that the stay-at-home spouse supported the high-income spouse during training and has become accustomed to a certain standard of living and thus alimony is awarded. The guidelines for child support are much more specific but do vary from state to state. In general, the amount of child support awarded has very little to do with the actual costs of raising children, but rather is calculated based on the income of the non-custodial spouse (another contributor to the financial devastation of divorce to a high-income professional). In some states (including my own), child custody is still awarded in a case of joint physical custody. In this situation, the child support each spouse would owe a custodial spouse is calculated and the difference is paid by the spouse with the higher income to the spouse with the lower income. From a tax perspective, alimony is considered a deduction to the payer and taxable income to the recipient, however child support is not a deduction to the payer and is not taxable income for the recipient (Update: with the recent passage of tax reform, for divorces finalized after December 31, 2017 alimony is no longer a deduction to the payer). Other costs associated with raising children may not be covered by child support such as educational expenses, which are often the responsibility of the high-income spouse.

Taxes

Here is some more bad news. You must file taxes based on your marital status on December 31. So if you are divorced in December, and taxes were withheld throughout the year based on the assumption that you would be filing jointly, then you will likely owe a huge tax bill. Your options are either to file single or head of household. Head of household is definitely preferable. The parent who has the children for more than one-half of the year can claim head of household filing status. This should be considered in the divorce agreement even in the case of joint physical custody (e.g. if the high-income parent has the children for 183 out of 365 days, then he/she can file as head of household). This is different than determining who will claim the children as dependents, which is usually addressed in the divorce agreement. There are multiple options with regard to claiming dependents including alternating years between which spouse claims them and allowing each spouse to claim a different child as a dependent. In addition, all that money you spent on your divorce is not tax deductible.

Conclusion

In conclusion, divorce is terrible! It’s terrible on many levels, but in particular, if you are a high-income professional get ready for a huge blow to your finances. However, the magnitude of the impact can be minimized if one carefully considers the financial implications of each decision in a divorce and obtains high-quality professional help. My hope is that this article is both a helpful tool for those facing a divorce and a motivation to everybody else to love your spouses well and prioritize your marriages.

Have you been through a divorce? What advice do you have to share with those who are going through it? Share your experience and comment below.