Financial Chores To Complete After Divorce

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[Editor's Note: This is a guest post from Aaron Kahn, a financial advisor with [Wealth Management Strategies, Inc.](#) We have no financial relationship. A number of readers have asked for a post on divorce. I'm certainly no expert on the subject, but divorce can be a personally and financially devastating experience and is certainly worth a discussion. This might not address all questions readers may have on the subject, but it is certainly a good start.]

Divorce is an unpleasant and often agonizing activity. Take note of the following four retirement to-dos, so that you avoid letting simple mistakes grow into monumental frustrations. While I am not a divorce attorney, has a Certified Divorce Financial Analyst that I work with on cases where our clients, many of whom are physicians, wish to dissolve their marriage in a collaborative atmosphere.

For those dissolving their marriage, the general consensus is probably that the easiest way to avoid mistakes during a divorce is to avoid marriage entirely. While that may be true, the fact of the matter is that may no longer be an option. If you follow these 4 to-dos however, you will likely avoid the most common (and costly) mistakes people make with their use-property (house, cars, and other personal property) and retirement accounts during the separation of assets.

Beginning with the “easy” decisions, let’s talk about the tangible assets like your house, cars, and personal property. Granted, it may be a bit presumptuous to say that any part of a divorce will be easy. However, use-property tends to take on a level of necessity in each spouse’s life. That necessity breeds metrics for the separation of assets, which ultimately helps to simplify the division as you move forward. When you establish separate residences, it is reasonable to assume that you will both need furniture and transportation.

 # 1 Establish Use-Adjusted Values

To start, individually rank your furniture and modes of transportation on a scale of 1 to 5, based on the frequency of use while you two shared a household. A ranking of 1 should be applied to a piece you never touched after it was purchased and 5 being a piece that you used every day. Next, divide your use ranking by the condition of the property: 1= nearly-new and 5= barely-salvageable. Finally, multiply this number by the price of a comparable product, should it need to be purchased today. This will give your use-adjusted value.

For example, the family room furniture set was used every day. It includes well-made pieces, but has also been ‘well loved’. Your living room is furnished with antique pieces, fit for a museum. The antique pieces are in impeccable condition and would look great in any home, but will never be used on a daily basis. Since the family room furniture was used daily, let’s assign it a 5 for necessity, but a 3 for condition. If a comparable set of furniture would cost $10,000, the set’s use-adjusted value will be $16,667. In contrast, let’s assign the living room set a 1 for necessity, but a 5 for condition. If an antique store would appraise this set at $10,000 as well, its use-adjusted value is only $2,000.

Now that you've established use-adjusted values for your use-property, separate each piece into categories based on function. By quantifying the value of an asset based on its function and condition, you are essentially giving your possessions a price tag, based on its value in your lives.

 # 2 Update Your Beneficiaries

By law, your spouse has to be the beneficiary on qualified retirement accounts and at the moment, is entitled to receive all of your retirement assets, in the event of your death. However, after a divorce, that rule no longer applies. The single most common mistake made after a divorce is that former spouses neglect to change the beneficiaries of their retirement accounts.

According to a 2009 Supreme Court ruling, the beneficiary designation you elect for your retirement account trumps a property settlement. While you're updating the beneficiaries on your retirement accounts, take some time to review your other assets, such as joint-ownership accounts, life insurance policies, and annuities. If you have minor children or plan to get remarried, now may be a good time consult an estate attorney about establishing a revocable trust for these assets.

 # 3 Properly Transfer Your Retirement Accounts

Hypothetically, you are moving forward in the process of separating your assets. The use-assets like the house, cars, and personal belongings aren't posing a significant problem, but you have personally saved a substantial amount of money in retirement accounts. That Traditional IRA you opened after medical school has grown to $500,000 and another $500,000 is in your 403(b) plan, through the hospital.

Example 1: Your $500,000 Traditional IRA

The property settlement agreement must outline ‘*who gets what’*. If the divorce decree includes your IRA and the method of transfer is improperly titled, you will be forced to pay both income tax and an early-withdrawal penalty if you are younger than 59 ½. To avoid unwarranted expenses, ensure that assets transferred from your IRA to your soon-to-be-ex spouse are titled as a ‘*transfer incident to divorce*.’

This title ensures that your IRA is re-titled in your former-spouse’s name or is a direct transfer to an IRA account owned exclusively by your ex-spouse. He or she now assumes complete ownership of the assets, personally paying taxes on any distributions, when taken. Transferring incident to divorce also simplifies investment management and distribution matters, because the recipient spouse has the liberty to do with the money anything he or she desires. If he or she wishes to move the account into a Roth IRA for instance, the conversion process is exactly the same as if the IRA being converted was always individually owned by the ex-spouse.

To illustrate the costs of an improper transfer of your $500,000 IRA, please see the chart below. Tax rates and dollar amounts will vary depending upon your state of residence and federal income tax bracket. The chart assumes that you are in the highest federal income tax bracket (39.6%) and live in Pennsylvania, which has a flat income tax (3.08%).

Tax	Rate	Amount
Federal	39.6%	$198,000
State*	3.08%	$15,400
Penalty	10%	$50,000

TOTAL	**52.68%**	**$263,400**

Example 2: Your $500,000 403(b) (or Other Qualified Retirement Account)

To split a qualified retirement plan, a Qualified Domestic Relations Order (QDRO) is required. If the money is kept in the qualified plan, the terms of the plan will dictate when the funds will be paid to a receiving spouse via the QDRO. Alternatively, the receiving spouse has the right to roll the assets into his or her personal retirement account.

The QDRO resembles a 'transfer incident to divorce', in that the receiving spouse is granted the right to handle the assets as he or she desires and the transaction is tax-free, if completed properly. If the receiving spouse transfers the assets into a Roth IRA, he or she will have to pay income tax on the entire value of the transfer, but no 10% penalty.

 # 4 Reassess Your Retirement Preparedness

To compound the distress stemming from the divorce process, too many people are reticent to reassess their financial situation following a property settlement. It is critical to redefine your budget and your retirement projections, in light of your new circumstances. Reassessing your preparedness does not always highlight deficiencies, however. In the months following your divorce settlement, monitor your cash flows, because you may realize you're able to save more now that court costs and attorney-fees are no longer an expense.

Divorce is never easy and the anxiety it elicits can root simple oversights that mature into agonizing burdens. While you will be working with lawyers, mediators, accountants, and/or financial advisors, it is important to educate yourself about the divorce process. Even seasoned professionals make mistakes and as physicians, the last vexation you need is another distraction from your already hectic schedule.

Aaron asked that the following statement be included to keep his compliance department happy: Securities and Investment Advisory Services offered through NFP Advisor Services, LLC (NFPAS), member FINRA/SIPC. NFPAS is not affiliated with Wealth Management Strategies, Inc.

What do you think? Have you been divorced? Financially-speaking, what was the hardest aspect? Any other tips you would include for high-income professionals considering or going through a divorce? Comment below!