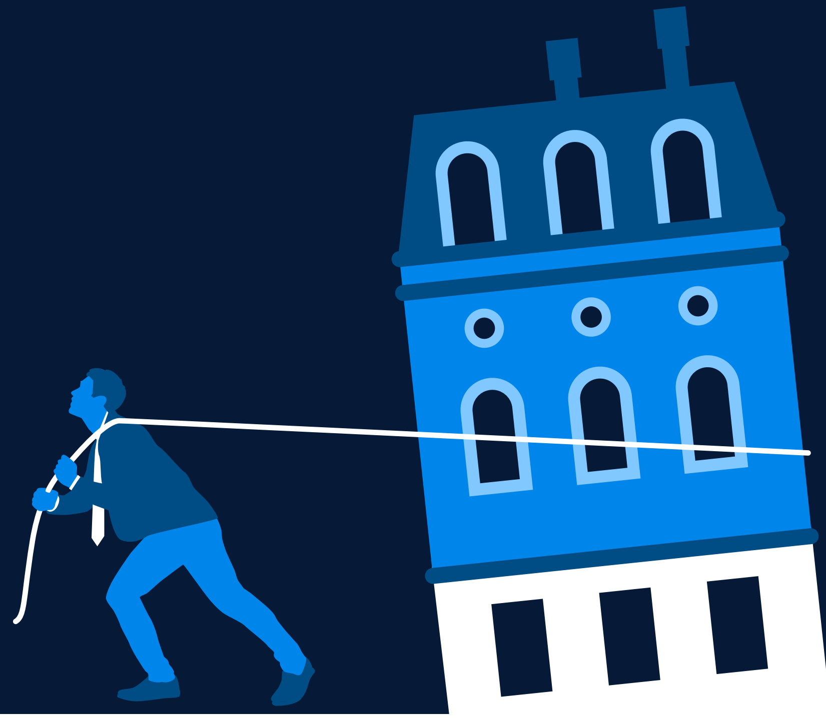
T. Rowe Price

Take financial control of your life during and after a divorce



Make Your Plan
July 2024

Key Insights

- As you prepare to separate, carefully consider how your financial reality will change and what reasonable accommodations you might request (or make) to see that both you and your spouse exit the marriage on firm financial footing.
- Knowing what you earn, spend, own, and owe (both individually and as a couple) will enable you to have more open, honest discussions about potential trade-offs.
- Be sure to include real estate, insurance, college funds, and retirement assets in your immediate negotiations as well as your long-term plan.

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Even when the proceedings are amicable, divorce often comes with emotional, logistical, and financial challenges. Whether you're just starting the process of separation or you're already in the throes, it's important to consider your personal and financial needs and how your priorities may need to adapt. Though the uncertainty and distress often associated with such a major life event can make it difficult to see beyond the present, it may prove productive during this time to contemplate and outline a plan for the life you envision long term—once the dust from the divorce has settled.

Focus on the best possible outcomes

Remember that negotiations are crucial to achieving the best possible outcome, and avoiding unnecessary litigation could save time, money, and stress. Focusing on your goals, advocating for yourself (while being realistic about potential compromises), and remaining active and engaged in the process can prove vital for achieving an optimal result.

Know your options for negotiating a divorce settlement

Some couples who manage to reach a compromise on their own can simply hire an attorney (or go online) to compose a legal divorce settlement agreement and file it with the court.

Other couples, who are unable to find common ground or simply have more complex issues, must explore other avenues. A "negotiated settlement" is often characterized by a back-and-forth between each spouse's attorney to obtain the best possible terms for their client. Litigation involves achieving a settlement through the court system. Both of these methods can result in an expensive, lengthy, inefficient, and sometimes antagonistic process. For this reason, many couples consider alternative strategies such as **mediation** or **collaborative divorce**. These alternatives may prove attractive for couples who are unable to navigate an agreement independently but are willing to compromise.

Mediation typically involves bringing in a neutral third party, usually a consulting attorney, to provide guidance and help both parties work through the issues in a calm, communicative manner. **Collaborative divorce** requires the willingness and financial capacity for each spouse to hire their own attorney to represent them and serve as their negotiator (with their clients present) until issues are resolved and a settlement is reached. During the process, attorneys often hire professionals with expertise in relevant areas (such as financial planning, accounting, childhood psychology, etc.) to offer insights and guidance that might help move the negotiations in a positive direction.

Another unique aspect of collaborative divorce is that if either spouse threatens to take the other to court at any time, proceedings are immediately concluded and neither lawyer is ethically permitted to represent the parties further.[1] This caveat may provide additional incentive to compromise for couples whose issues are more complex and/or whose personal relationship is particularly strained. Of course, if mediation or collaboration is unsuccessful, the divorce may eventually proceed in court.

Financially prepare for your divorce

In addition to obtaining sound legal advice, it's important that you engage a financial professional who can educate you on the implications any proposed settlement terms may have on your financial wellness. To properly assess your situation, it's crucial to fully understand your family's finances, including your **assets, debt, income, and expenses**. Obtaining 12 months of up-to-date information (examples below) can arm you with the knowledge needed to pursue substantive negotiations.

If you're unable to obtain this information, it will eventually become discoverable in court, but discovery can be expensive, intrusive, and time-consuming. So the more information you can gather ahead of time, the smoother the negotiation process may be.

Understand the financial elements of a divorce settlement

Divorce settlements can impact every aspect of your financial life. This is especially true if you have minor children.

[1] "Collaborative Divorce vs. Mediation: Which Is Right for You?," https://divorce.com/blog/collaborative-divorce-vs-mediation/, March 2023.

Fully understanding your family's finances

(Fig. 1) Obtaining 12 months of up-to-date information can arm you with the knowledge needed to pursue substantive negotiations.

Asset and Income

- Pay stubs
- Income tax records
- Bank account statements
- Investment and retirement account statements
- Social Security and pension estimates
- Insurance policies
- Property deeds and car titles

Debt and Expenses

- List of monthly and annual expenses
- Credit card statements
- Credit reports
- Mortgage, student, auto, and personal loan documents and statements
- Tuition and school fee records

> "The more you and your spouse can agree upon and accomplish together, the more financially advantageous it could be for both parties. But while compromise can prove helpful and lead to better outcomes, be sure to prioritize, and not sacrifice, your own financial needs in the negotiation process.
>
> – Lindsay Theodore, CFP®
> Thought Leadership Senior Manager

From child support and alimony to real estate and **retirement accounts**—consider your whole financial picture while negotiating your settlement. Divorce settlements generally include many (or all) of the following elements:

Alimony

If you're the lower-earning spouse, regardless of your gender, alimony can help you maintain your standard of living and access the education and training necessary to build your earning power and become self-supporting. Alimony payments are not guaranteed to be awarded, but when they are, factors such as the length of the marriage, the earning potential of both parties, the ability for the higher earner to pay, nonmonetary contributions to the household by the dependent spouse, and the standard of living established during the marriage will impact how much and how long alimony is ultimately awarded. Payments resulting from divorce settlements signed on or after January 1, 2019, are neither taxable for the recipient nor tax-deductible for the payor.[2]

Child support

States typically dictate a formula for child support payments, which are designed to ensure that minors are provided for by both parents until they reach age 18. Child support payments are neither taxable for the recipient nor tax-deductible for the payor.

529 plans and education funding for children

If applicable, it's prudent to plan now for college expenses by including details in the divorce settlement about how much each parent will contribute toward their kids' educational expenses now and in the future. Accounts such as **529 plans** can assist parents in accumulating funds earmarked for education on a tax-advantaged basis. In the case of divorce, your divorce settlement agreement can outline how ownership (custodial control) of existing 529 assets should be divided.

Ownership of a 529 plan account may affect **financial aid**. Generally, the parent who provides the most financial support for the child is responsible for completing the Free Application for Federal Student Aid (FAFSA) based on their household's income and assets. If parents split financial support equally, guidance from the U.S. Department of Education indicates that the FAFSA must be completed by the parent with greater income.[3]

Assets, including 529 accounts, owned by a dependent student or the parent filing the FAFSA are considered parental assets counted toward determining the Student Aid Index (SAI).[4] Assets owned by the parent not filing the FAFSA are not included in the SAI calculation. Starting with the 2024–2025 school year, qualified 529 plan distributions, cash support, and amounts paid on behalf of a student (from any parent, grandparent, or other individual) no longer count as untaxed student income for the purpose of financial aid qualification.[5] As you negotiate the division of education-related expenses and accounts, think about who will likely file the FAFSA and how retitling of education-earmarked accounts might impact your child's financial aid eligibility.

Real estate

Your home may represent a substantial portion of your assets. Of course, it's also often where you live, which can make its disposition during divorce particularly challenging from an emotional perspective. Along with considering your emotional

[2] Alimony payments resulting from divorce settlement agreements dated prior to 1/1/2019 are typically deductible to the payor and must be reported as taxable income by the recipient.
[3] https://www.savingforcollege.com/article/divorce-and-the-fafsa
[4] The Student Aid Index (SAI) is used to determine a student's ability to pay for college. It depends on many factors, with the most important being household income. Generally, the higher a student's SAI, the lower the potential financial aid "need."
[5] https://www.savingforcollege.com/intro-to-529s/does-a-529-plan-affect-financial-aid

relationship to the home(s) and whether its ownership will still fit your budget, space requirement, and lifestyle needs as a soon-to-be single person, it's important to understand your disposition options.

Real estate is commonly handled one of four ways:

The couple can sell the property and split the proceeds. While this option is straightforward, the complication is that both spouses (not just one) would need to secure a new residence.

The couple can maintain ownership together, then sell later. If a couple opts to keep the property, a plan for division of financial obligations associated with the home (such as mortgage payments, taxes, insurance, and maintenance) and how sale proceeds (and taxes owed[6]) will eventually be handled, can and should be outlined in the divorce settlement.

One spouse can "buy out" the other. A buyout typically requires one spouse to apply for a new mortgage in his or her name, borrowing enough to pay off the previous loan and paying the other spouse their share.

Transfer ownership. If the home is owned mortgage-free and the other expenses are manageable for the spouse who prefers to keep it, the spouse who plans to move out may opt to hand over ownership. In this case, the spouse who is willing to relocate may be awarded a greater share of other assets to account for their portion of the home's equity.

Investment and retirement accounts

The disposition of assets in taxable accounts, such as brokerage and bank accounts, and tax-deferred retirement accounts, such as individual retirement accounts (IRAs), 401(k)s, and pension plans, will also be outlined in your divorce settlement. If you pursue divorce through the court system, division of the assets will be driven by state law. Nine states apply a concept known as community property, in which all earnings, assets, and debt accrued over the course of the marriage are split evenly, sometimes regardless of formal ownership.[7]

Most states, however, employ a concept known as equitable distribution, by which all earnings, assets, and debt are divided between the parties in a way the court deems fair—but not necessarily equal. For instance, if one spouse has a high, steady income and a sizable 401(k) plan balance while the other spouse spent most of the marriage caring for the children

> "If one spouse gets the house, the other spouse may then receive other, more liquid financial assets to offset it. Keeping the house can mean giving up liquidity in exchange for an asset that requires maintenance and property taxes.
>
> – David Twenhafel, CFP®
> Senior Financial Consultant

[6] Typically, each spouse can exclude up to $250,000 of realized gains from the sale of the home, provided you both own the home and it served as your primary residence for 2 of the 5 years before the sale, regardless of your marital status. However, the spouse who moves out and no longer claims the home as their primary residence may lose out on their portion of the gain exclusion at sale, effectively cutting the total capital gains exclusion from $500,000 to $250,000.

[7] Community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

Social Security benefits after divorce

You may be able to claim benefits on your former spouse's record—even after a divorce.

While your marriage may have ended, you may still be eligible to claim Social Security benefits on your former spouse's record. Eligibility requires that you are age 62 or older, were married 10 years or more, and are not remarried. If you meet all these criteria, and your ex-spouse has already claimed their own benefits, you're then eligible to claim divorce benefits. If your ex-spouse has not yet claimed, you may still be eligible to claim divorce benefits, provided your ex is over age 62 and you've been divorced for at least two continuous years. Claiming these benefits, at any time, will not affect the size of your former spouse's benefit. However, if you file for benefits prior to your full retirement age, your benefit will be reduced.

If you are eligible for retirement benefits on your own record, you will receive that amount first. If your benefit based on a former spouse is higher, you will receive an additional benefit so the total matches that higher amount.

and the household, the latter spouse may be awarded a higher percentage of assets. While not equal, a judge might consider this fair since the higher-income spouse likely had access to a savings plan that the homemaker spouse did not and has income that might allow them to reliably rebuild that balance after the divorce. Alternatively, if the lower-earning spouse is awarded alimony payments, the higher-earning spouse may be awarded a greater share of the asset balances.

To outline details on division of qualified retirement plan[8] assets, a legal document called **a qualified domestic relations order (or QDRO)** is typically included in your divorce settlement. A QDRO payout can be received as taxable installment payments, as a taxable lump sum, or as a nontaxable transfer or rollover to an eligible retirement account. If assets you've received via QDRO are retitled but kept in the same qualified retirement plan, any subsequent distributions will be taxed, but the 10% early withdrawal penalty will be waived.

Debt

Debt, like assets, especially if handled through the court system, is often divided between spouses based on state law and/or "fairness." For instance, the higher-income spouse or the spouse awarded a greater share of assets may be assigned a greater percentage of the marital debt. While not equal, this may be deemed fair because that spouse has higher income and/or assets necessary to service and pay down those obligations incurred during the marriage.

Insurance

Life insurance is often a key component of financial planning and lifestyle protection for married couples, especially if young children are involved. But in the event of a divorce (and/or if your children are grown), it's likely you'll want to change your beneficiaries or, perhaps, discontinue coverage. However, if you or any minor children might suffer financially in the event of your or your ex-spouse's passing, you could insist upon insurance coverage as part of your settlement.

If you're covered by your spouse's health insurance plan, you'll need to explore options for establishing your own coverage once the divorce is finalized. Keep in mind that while some states allow health care plans to continue covering ex-spouses, many do not. Most states and health care plans, however, do allow eligible children to remain on the policy. If you lose coverage due to your divorce or legal separation, federal law gives you the right to continue coverage for 36 months through the Consolidated Omnibus Budget Reconciliation Act (COBRA), though you'll be responsible for the full premium. If you lose coverage and opt out of COBRA, you'll qualify for a special enrollment period through the **federal health care marketplace**. If you established a *long-term care insurance policy* as a couple, make sure you understand how that policy will be impacted by the divorce, as well as the options available to you.

Consider your total insurance cost and coverage options carefully and prior to the divorce being finalized. This way, in addition to ensuring continuity of protection for yourself and your children, you can see that any financial assistance required from your ex-spouse to afford your coverage is specified in the final agreement.

Control what you can, and make compromises where appropriate

Remember that you and your spouse aren't required to heavily involve competing attorneys, a judge, or the court system in your proceedings at all. Together, and

[8] A qualified retirement plan includes any employer-sponsored retirement plan subject to the Employee Retirement Income Security Act of 1974 (ERISA) guidelines—including 401(k), 403(b), profit sharing, deferred compensation, and pension plans. A QDRO is not required to split IRAs or taxable accounts.

with input from an objective financial planning professional, you may even be able to divide assets in a mutually beneficial manner that an attorney or judge would not be expected to consider.

For instance, you both may agree for the lower-income spouse to receive a higher gross amount of total assets, but primarily tax-deferred assets (which will be taxed as ordinary income upon withdrawal), and the higher-income spouse to receive less overall, but primarily taxable assets (which will receive more favorable capital gains tax treatment upon sale). Due to your differing income situations, this division may prove mutually beneficial because you will each likely keep more of the respective assets you've received (after tax) than if all asset types were split proportionately.

Whether one-on-one or through mediation or collaborative divorce, greater satisfaction with the fairness of the outcome might be achieved if you, not the court, ultimately decide.

Make a fresh financial start

You can begin reestablishing your financial life as soon as you begin your separation, including reassessing your goals and making plans to work toward them. A trusted financial advisor can help you review your finances and address the following items:

Create a budget that aligns with your new income and expense situation. Many major household expenses that were previously shared (such as housing and health care) will now need to be paid independently. This may require trimming expenses, particularly in housing, or reducing your spending outlay in other areas. While not ideal, it may be necessary, and finding a trusted advisor to help you navigate those newfound changes is crucial to forming a path toward financial sustainability.

Update your retirement plan. An advisor can provide personalized education and recommendations regarding your retirement preparedness, savings rate, investment mix, holdings, asset allocation, and Social Security options. (See Social Security benefits after divorce.)

Once the divorce is finalized, address and enact any necessary changes to your estate plan and authorized parties. This would include updating trusted contacts, authorized traders, executors, trustees, and beneficiary designations on all accounts, life insurance policies, wills, and trusts. It is especially important to work with a legal professional to update your will and/or trust documents and revise your power of attorney and health care proxy documents (as your designated decision-maker has likely changed).

Prior to, during, and after your divorce, working with a trusted financial advisor who is well acquainted with your goals can help you develop a realistic pathway to meet them. With reasonable expectations, preparation, proper guidance, and willingness to adapt, the post-divorce life you envisioned can, eventually, become a reality.

> Amid all the uncertainty and emotional drain, advocating for yourself, while focusing on the factors within your control, can prove crucial to creating a positive path forward for rebuilding your financial and personal life.
>
> – Lindsay Theodore, CFP®
> Thought Leadership Senior Manager

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