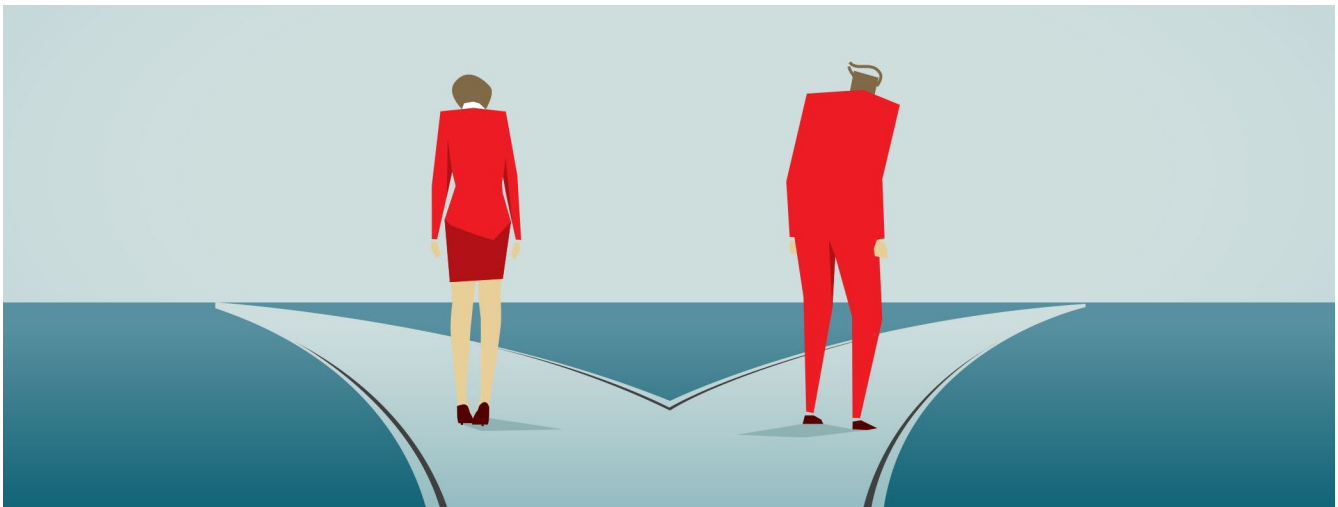


Gray Divorce

Financial Considerations When Marriage Dissolves at or Near Retirement



A lot has changed in the last 25 – 30 years. Fashion, technology, healthcare and even the food we eat are very different today than they were back in the 1990s. Just look at a photo of yourself from back then and you will likely be laughing at your hairstyle or what you were wearing.

Another trend that has developed since the 1990s is the divorce rate for couples over age 50. Long-term marriages that end in divorce at age 50 or older have doubled¹ which means one in four divorces in the U.S. is now a “gray divorce”. For couples age 65 and older, the divorce rate has tripled.²

¹ Pew Research Center, Fact Tank, March 9, 2017, “Led by Baby Boomers, divorce rates climb for America’s 50+ population”.

Some blame increased longevity for this new trend as individuals question whether they want to remain in a long-term relationship or marriage as they become empty-nesters, approach retirement, or adjust to life together after a recent retirement. Regardless of the reasons, the reality is a divorce at or near retirement can have devastating impacts on families and financial resources alike.

Long-term marriages tend to have more assets to divide and therefore it may take longer to reach a settlement agreement. Even when the divorce is amicable or collaborative, it is important to

² Source: National Center for Health Sciences and U.S. Census Bureau.

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understand that there is a difference between equal and equitable when dealing with the division of marital assets. In addition, if you find yourself needing to redesign what once was a single retirement planning strategy for two people into two separate retirement strategies, you will likely need some education and guidance.

Divorce is not a topic most couples want to talk about. However, with a major life event like divorce, it is important to talk not only with your attorney, but also with a financial advisor and a CPA or accountant. Your home, retirement accounts, pension and Social Security income, alimony, and the tax implications of these assets and income are important considerations that should not be overlooked.

Housing

The home may represent a lifetime of memories. For many couples it is difficult to put emotions aside and look at the home as a financial decision. There may be many ways the ownership of the marital residence can be dealt with during a divorce. Two common scenarios are one spouse will keep the house and buy out the other spouse's equity in the home or the family home will be sold, the proceeds divided between the spouses, and used to establish two separate households. Financially, both approaches have impacts that need to be considered. A financial advisor can help you with planning for either scenario by working with you to develop a budget.

If you are considering keeping the home, costs that may have been shared now would become your responsibility. Known costs – which include more predictable expenses like your mortgage (if any), utility costs, property taxes, and homeowner's insurance, as well as routine maintenance – need to be addressed first. Then consider the additional costs associated with the upkeep of the home that you

didn't have to pay for in the past. Are you going to need to:

- Hire a handy man to fix something when it breaks?
- Pay for lawn care services?
- Eat out more because your ex-spouse did all the cooking?
- Pay for a cleaning service every week?

Other household costs like groceries, cell phones, gas, car payments, auto and health insurance are just a few more things you will need to consider as you create a new budget. Taking the time to review the budget early on, will help you decide which course of action is right for your situation.

Retirement Savings Accounts

If you spent decades working together to save for retirement as a married couple, you may also be wondering how those tax-advantaged savings accounts will be divided after a divorce. A qualified domestic relations order ("QDRO") will be required to address the division of any type of employer-sponsored retirement account after a divorce. That includes 401(k) plans, profit sharing plans, 403(b) plans, ESOPs, and other types of "qualified" retirement programs provided through an employer.

When you discuss the division of these assets with your attorney, keep in mind that they are taxable to you when distributed. Since taxes come out of retirement account income, you may want to review the net taxable amount each spouse will receive. In addition, there are age limits where penalties can apply that may limit access to these assets right away. For example, distributions to a plan participant prior to age 59 ½ are generally subject to a 10% early withdrawal penalty, but that penalty can be waived in situations where the participant separates from service or retires in the year they turn age 55 or older. The 10% penalty can also be waived if an

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employer-sponsored retirement plan distributes benefits to an ex-spouse under a QDRO. QDROs typically are drafted after the divorce is final, so discuss details with your attorney like who is going to pay for the QDRO, who is going to request the QDRO, and how long it generally takes to get the QDRO issued.

IRAs, including traditional, Roth, SEP and SIMPLE IRAs, do not require a QDRO and can generally be divided between the two spouses with the judgement of divorce or a legal separation agreement. With IRAs, there is no exception to the 10% early withdrawal penalty for divorce. Once an IRA is divided between spouses, withdrawals taken before age 59 ½ are typically subject to the 10% penalty.³

Pensions

Traditional defined benefit plan pensions are a source of retirement income that should be carefully considered, especially if you are not the participant in the pension plan. A QDRO is also required to address whether a non-participant spouse can receive part of the pension income.

With a pension plan, a married couple will typically receive income beginning at the participant's retirement and payments continue until the death of the second spouse. When the participant dies, a surviving spouse may receive 50% or more of the pension depending on the type of survivor benefit elected at the pension's start date. In some cases, survivor benefits may be waived if the spouse consents before monthly payments begin. A pension earned during years of marriage together is considered a marital asset. Discuss with your

attorney what will happen to the anticipated retirement income from the pension after the divorce.

- What, if any, pension income will you receive (or continue to share)?
- Will any survivor benefit be paid to you after the participant-spouse dies?
- Will the rules of the plan permit payments to be made directly to the non-participant spouse now or in the future?

Depending on the answers to these questions, your attorney can address ways in which the marital settlement agreement can address the value of the pension benefits. For example, one option may be for you to give up your rights to current or future pension benefits in exchange for cash or other assets, such as the equity in your home.

Social Security

Social Security is another important retirement income consideration. After a divorce, you may be able to receive Social Security benefits based upon your ex-spouse's work history. To qualify, four criteria must be met:

1. Your marriage must have lasted for at least 10 years prior to the divorce. The 10-year period begins with the date of marriage and ends with the date of the final decree of divorce.
2. You must be unmarried.
3. You and your ex-spouse must be at least age 62 (the earliest age to claim Social Security benefits) and entitled to benefits.
4. The dependent spousal benefit must be greater than your own.

If your divorce ended at least two years earlier, then you may be able to begin spousal retirement benefits

³ The 10% penalty does not apply to IRA withdrawals prior to age 59 ½ if the distribution is due to death, disability, for a first-time

home purchase, higher-education expenses, or for certain other exceptions. Consult your tax professional for details.

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even if your ex-spouse is not collecting Social Security; otherwise, you'll have to wait until your ex-spouse is receiving Social Security.

The maximum spousal benefit is limited to 50% of the ex-spouse's Primary Insurance Amount (PIA). The maximum amount is only available if you wait to collect those benefits until your own full retirement age (FRA).

In addition to spousal retirement benefits, survivor benefits may also be available after your ex-spouse dies, as long as you are unmarried, your marriage lasted for at least 10 years, and you are at least age 60 (age 50 if you are disabled). The maximum survivor benefit is available if you file for benefits on or after your FRA and is typically 100% of the amount the deceased ex-spouse was receiving at the time of his or her death, or the amount they would have been entitled to if they were not already collecting benefits.

If you re-marry, you will forfeit any spousal retirement income benefits you were receiving from your ex-spouse (although you may be able to collect Social Security from your new spouse). In addition, if you re-marry before age 60, you will also forfeit the ability to collect a survivor benefit from a deceased ex-spouse. Re-marriage after age 60 will not cause your survivor benefits to be forfeited.

Alimony

In a long-term marriage, alimony (sometimes called "maintenance" or "spousal support") may have to be provided for a certain period of time and, on some occasions, for life. Whether you are the payor or the receiver of alimony, you need to include this source of expense or income in your financial plan.

Beginning in 2019, tax treatment of alimony changed. Prior to 2019, if you paid alimony, you were able to take a deduction for those payments. If you received alimony, you reported the payments as taxable income. Beginning in 2019, alimony payments are no longer tax deductible for the payor and they are not treated as income for the recipient. If you have a marital settlement agreement (MSA) that was negotiated on the tax treatment of those payments and the divorce isn't final yet, you may want to consult your attorney to see if the MSA should be revisited.

Tips for Navigating a Gray Divorce

More often than not, supporting two households on the same amount of income as before the divorce can create financial hardships that can blow up the best laid plans for retirement. Lifestyle changes may need to be made if your finances don't stretch as far as they did before, and when divorce happens later in life, you have less time to make up ground before retirement. For some, re-entering the job market at an older age to help make ends meet might also be more difficult than anticipated.

If you find yourself contemplating a gray divorce, or you are currently in the midst of one, here are some tips to guide you through your financial discussions:

- **Take Financial Inventory** – Look at your income, assets, and liabilities. Take a snapshot of everything and get the information organized.
- **Create a Budget and Do Some Planning** – Work with a financial advisor to ensure you understand your current ongoing expenses, who will be responsible for paying them, as well as the sources of all current and future income.
- **Realize it is Not Likely to be Cheaper** – According to a 2014 Government

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Accountability Office report to the Senate Special Committee on Aging, a single person age 65 or older needs 79% of the income of a two-person household (not 50%). Older divorced women are also 80% more likely than men to be in poverty at age 65 or older.

- **Manage Existing Debt** – Are there credit cards that need to be cancelled? Who will be responsible for payments of the existing debts? Do you have adequate credit history individually to obtain any anticipated loans or to re-finance existing loans for your home or your car?
- **Anticipate Future Expenses** – Will there be college education needs for your children? Are there items in your home that will need to be repaired whether you are staying or selling? Do you need to obtain your own healthcare benefits?
- **Discuss Income Tax Concerns with Your CPA or Accountant** – After divorce, your income tax situation will change. What will your new tax filing status be? Will you itemize or use the standard deduction? Who will claim any potential child/dependent exemptions? Does your paycheck withholding need to be adjusted?
- **Review and Update Beneficiary Designations** – Life insurance, annuities, IRAs, 401(k)s and other retirement accounts, and transfer on death accounts should all have the beneficiary designations reviewed and updated if changes are needed. You may assume that divorce automatically removes

an ex-spouse from their ability to receive assets after your death, but that is not always the case. For example, employer-sponsored retirement plans, referred to sometimes as ERISA plans, do not factor in divorce when an employee (participant) dies. Unless you take action to update and remove an ex-spouse from the beneficiary designation, your ex-spouse could still receive your retirement plan assets after your death.

- **Review Life Insurance** – If you have life insurance, find out if you are the policy owner and if the policy was written to cover your life or your ex-spouse's life. Policy owners can generally change policy terms and beneficiaries, or cancel the life insurance coverage. Policies that have cash value should be viewed as an asset and addressed in the settlement agreement. In some cases, a court can order a life insurance policy to be retained and prohibit beneficiary changes.
- **Don't Forget About Estate Planning Documents** - Your will, any trusts, or powers of attorney should also be reviewed and updated if necessary.

Divorce can be an emotional time for everyone involved. Avoid behavioral investing mistakes by using the expertise and experience of a financial advisor to help you take as much emotion as possible out of your financial decisions. Contact Benjamin F. Edwards if you would like help developing a plan for meeting your goals. ■

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