

# Five Financial Pitfalls of Gray Divorce

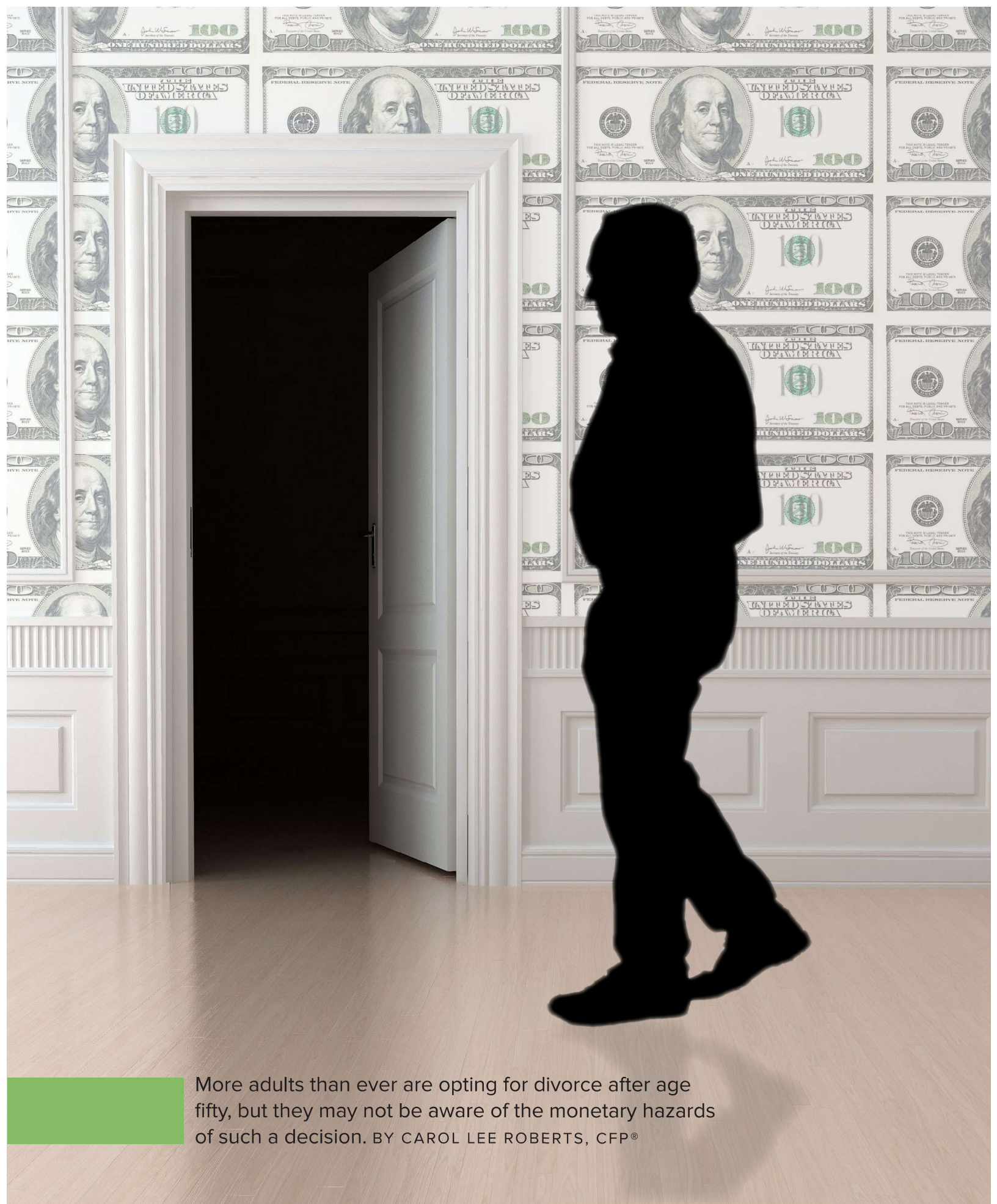
More adults than ever are opting for divorce after age fifty, but they may not be aware of the monetary hazards of such a decision.

*By Carol Lee Roberts, CFP®*



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# Five Financial Pitfalls of Gray Divorce

The decline in the overall divorce rate in the U.S., coupled with the increase in the phenomenon known as gray divorce, has received a lot of media coverage in the past few years. Divorce over age fifty brings with it myriad consequences — both obvious and unintended. Professionals can help raise awareness of these outcomes with older clients considering or undergoing divorce.

There has been much written on why divorce among older adults has more than doubled over the past twenty-five years (Moore, 2018), and tripled since 1990 among those sixty-five and older (Stepler, 2017). Some theorize about the impact of empty nest syndrome: couples who have stayed together while dedicating themselves to their children fall apart when offspring leave the family home. Another possible cause is an increase in longevity: as life spans increase and we're able to live many years in retirement, we have the opportunity to find a happiness or spark that a current marriage may be missing. Finally, the decrease in the social stigma of divorce over the last few decades has left us with a population over fifty that may be in their second or third marriage — or more. The likelihood of divorce increases with each subsequent marriage, increasing the divorce rate for older Americans.

It is notable that the increase in divorce among individuals over fifty is not unique to the U.S. The increased divorce rate in the United Kingdom has also been attributed to gray divorce (Sears, 2006). And in Japan, it is referred to as “retired husband syndrome” or the literal translation, “one’s husband being at home stress syndrome.”

Research from Susan Brown, a Bowling Green State University sociology professor and co-director of the National Center for Family & Marriage Research, indicates that a post-fifty divorce creates a 50 percent decrease in wealth, corresponding to a 45 percent decrease in the standard of living for women and 21 percent drop for men (Brown & Lin, n.d.). Research shows economic well-being in single older adults is often compromised when they are divorced women, who often have high poverty rates in comparison to widowed, who were found to be among the most advantaged singles of either sex (Lin, Brown, & Hammersmith, 2016). And no matter if you're the husband or wife, getting divorced cuts your retirement readiness in half. While the cost of living is less for one person rather than two, it is not half, and divorced people find they can't live to the same standard as before (Pinsker, 2017). Even more concerning is the study's conclusion that divorce at this point in an individual's life does not provide the opportunity to recover financially. Most people show little or no recovery in their financial status (Journals of Gerontology, 2012).

Taking the above data into account, it's important for older adults to understand what's at stake regarding their future finances in the event of a divorce.

## Five Areas of Financial Concern

Divorce can have a substantial impact on the financial well-being of both parties. However, there are five areas where it is important to be cognizant of the unique financial and tax provisions related to divorce planning.

## 1. PROPERTY

The first area is the definition of property. Prior to arranging an equal or fair division of property, it is essential to identify the property to be divided. In order to do this correctly, each spouse must be able to distinguish between marital and separate property. A simple definition of marital property is property acquired during the marriage, with the exception of gifts and inheritances. Separate property is property owned prior to the marriage. However, some states view the increase in value of separate property during the marriage as marital property, and separate property can be converted to marital property through comingling.

Once the property to be divided has been identified, it must be determined if the divorcing couple lives in an *equitable distribution* or *community property* state.

In an equitable distribution state, issues that relate to both marital property and debt are divided in an equitable fashion according to the court at the time of divorce, unless the divorcing spouses have previously agreed otherwise. That doesn't mean that they are divided 50/50. The court will determine separate vs. marital property and distribute it accordingly in a way it deems fair (Justia, 2019).

A community property state, on the other hand, gives the husband and wife equal ownership of all monies earned by either of them from the beginning of the marriage to the date of separation, and all property purchased during the marriage with "community" money is owned by both spouses on an equal basis. Likewise, all debts accrued during the marriage are community debts, with both spouses liable. This

usually includes unpaid credit card balances, home mortgages, and car loans (LegalZoom, n.d.).

There are currently nine community property states as illustrated in green in Figure 1. Alaska is unique as individuals can opt in to community property treatment.

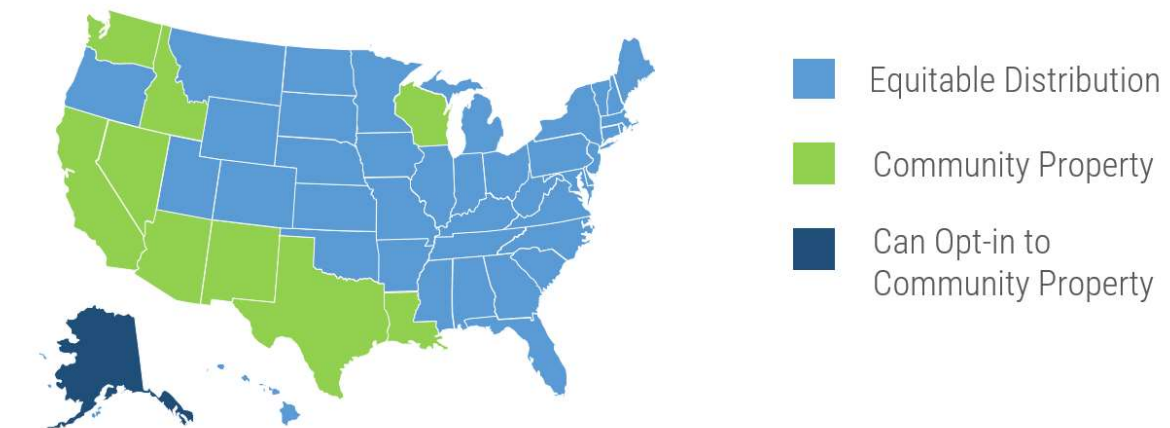
Once the determination has been made as to what property is subject to division, it is important to determine the cost basis of the property (how much was paid for it at the time it was acquired) and whether it is a use asset (as part of a business) or subject to special tax status. A division that might look equitable at first blush could be anything but.

For example, let's say that one spouse is keeping a retirement account [such as a traditional IRA or 401(k)] worth \$250,000 and the other is receiving a taxable investment account of highly appreciated stock worth the same amount. The retirement account will continue to grow tax deferred until assets are withdrawn at ordinary income rates, and required minimum distributions must start when the account holder turns seventy-two. However, the spouse who got the stock account must pay lower capital gains taxes at the time of sale on a high amount of appreciated assets, but is not subject to required withdrawals. Even if there is not an issue of capital gains, it is important to show the long-term impact of a settlement, rather than dividing assets based on a net worth statement that only provides a snapshot of the investment and no information on cash flow.

Finally, Internal Revenue Service (IRS) code provides that a gift to a spouse or family member does not provide a step-up in basis; the asset basis is still

FIGURE 1.

## Property Distribution by State



valued from the time of purchase, not the time it was gifted. The same is true if the transfer is pursuant to a divorce decree, within one year of the divorce, and occurs not more than six years after the divorce.

## 2. HOUSE

The second major consideration in divorce is the division of the marital home. The options for the marital home come down to selling the house, one spouse buying out the other, or one spouse remaining in the house while both maintain ownership. In the scenario where one spouse is buying out the other or where one spouse needs to purchase a new residence, reverse mortgage(s) can be a method of funding for older adults. There is also special tax treatment for the sale of the primary residence incident to divorce that allows the non-resident spouse to utilize both the ownership and residency period of the resident spouse on a home that is jointly owned after divorce. For example, if Susan and Ray were divorced seven years ago but the house remained in both names, Ray would also be able to exclude \$250,000 of capital gains based on Susan's residency in the home.

## 3. RETIREMENT PLANS

Retirement plans, the third concern, can be a substantial asset and may also need to be valued and divided. One of the factors that should be considered in the division of retirement assets is the amount of the plan that would be considered a marital asset. If the length of employment exceeds the length of the marriage, the entire plan would not be considered marital property.

Defined contribution plans, such as 401(k)s and

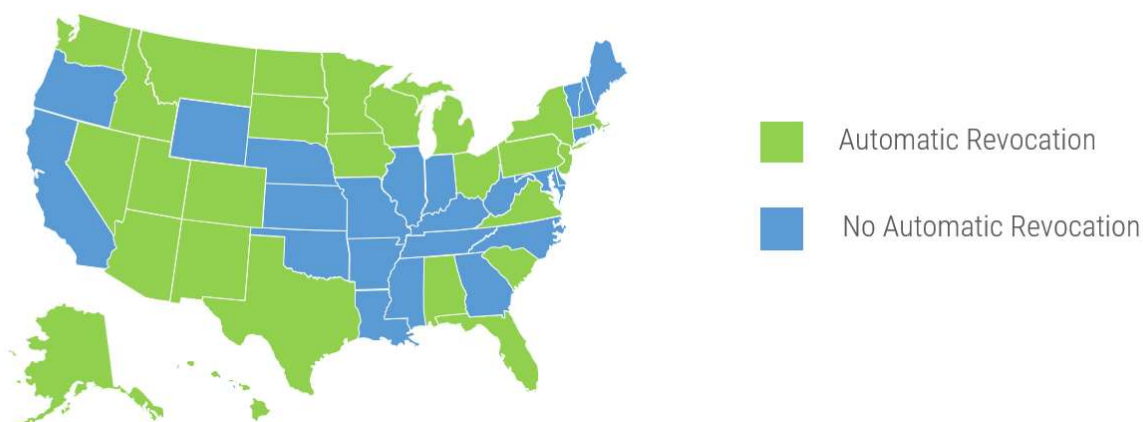
403(b)s, will provide a periodic statement of the cash value but should be reviewed to determine if there are any outstanding loans. A defined benefit plan, such as a pension, will not provide a current value and must be valued to determine an appropriate division. In the case of gray divorce, it is possible that irrevocable elections (such as opting for a joint and survivor annuity) have already been made and cannot be changed due to the divorce.

Whether or not a plan is qualified also has an impact. Qualified plans have tax-deferred contributions from the employee, and the employer may deduct amounts they contribute to the plan (Investopedia staff, 2019). Non-qualified plans use after-tax dollars to fund the plan and, in most cases, the employer cannot claim contributions as a tax deduction. Qualified plans can be divided by a qualified domestic relations order (QDRO). It is important to realize that a QDRO cannot order or provide any benefits that are not explicitly provided by the plan administrator. An affected spouse or his or her attorney should request a copy of the summary plan description (SPD) and ask to see if the plan administrator provides a sample QDRO. An IRA account is not divided by a QDRO; in most cases, a copy of the divorce decree and a signed distribution form are sufficient to divide an IRA account.

There is also a special tax provision that allows a one-time distribution from a qualified plan pursuant to divorce that is exempt from the 10 percent early distribution penalty. The plan administrator is still required to withhold 20 percent (which is intended to roughly cover ordinary taxes) and the distribution is

FIGURE 2.

## Beneficiary Designation and Automatic Revocation



still taxable income, but the early distribution penalty for those under age 59½ is waived. This provision does not apply to IRA accounts.

#### 4. INSURANCE

The fourth area of concern is insurance. There are several insurance provisions and concerns. First, if the plan is to guarantee a stream of income with life or disability insurance, that application should be made as soon as the parties realize that insurance is required. No one would want to base a post-divorce plan on guaranteed income only to realize that the individual was uninsurable.

The insurance should also be properly titled; ideally, the recipient of the income should own the policy or, at a minimum, be listed as an irrevocable beneficiary. The reason the recipient should own the policy is so that he or she will be informed of any changes or lapses in the policy.

Health insurance must also be considered. There are unique Consolidated Omnibus Budget Reconciliation Act (COBRA) provisions that apply to divorce. An individual is eligible for COBRA coverage for up to thirty-six months after divorce, as opposed to the eighteen months provided at the termination of employment. If one party is electing COBRA coverage, the company must be notified within sixty days of the divorce or the employer is not obligated to provide the COBRA option. The Affordable Care Act also allows divorcing individuals to purchase insurance outside of the normal sign-up period and will often provide a more affordable option to COBRA coverage.

#### 5. FOLLOW-UP

The fifth and final area of financial concern is the post-divorce follow-up. It is imperative that all changes or restatements of beneficiaries is completed. Many states currently have automatic revocation statutes that will void beneficiary designations that were made pre-divorce. In addition, a QDRO that is not properly drafted, or not accepted by the plan administrator, would be a problem for the client but could also become a substantial compliance concern for the planner. Figure 2 indicates those states that currently have automatic revocation statutes.

### Conclusion

Going through divorce after fifty doesn't have to be a financial disaster, but it can be a tricky and complicated experience. Understanding how assets and debt will be divided can increase awareness of what the post-divorce financial landscape will look like, and how to plan for it. Those going through a gray divorce — and their advisors — who keep these five critical

financial factors in mind will be sure to navigate the pitfalls successfully. •CSA



**Carol Lee Roberts** is the current president of the Institute for Divorce Financial Analysts and brings over thirty years of experience in the financial services industry to this position. She holds the Certified Financial Planner, Certified Financial Transitionist, and Certified Divorce Financial Analyst designations. Carol Lee has an undergraduate degree from Augustana College and a Master's Degree in Financial Planning from DePaul University. She authored the *Tools & Techniques* book, *Divorce Planning*. She can be reached at [CLRoberts@Institutedfa.com](mailto:CLRoberts@Institutedfa.com)

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